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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 75-1687

UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee for The Port Authority of New York and New Jersey Consolidated Bonds, Fortieth and Forty-First Series, on its own behalf and on behalf of all holders of Consolidated Bonds of The Port Authority of New York and New Jersey and all others similarly situated,

Appellant,

v.

THE STATE OF NEW JERSEY, BRENDAN T. BYRNE, Governor of the State of New Jersey, and WILLIAM F. HYLAND, Attorney General of the State of New Jersey,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

BRIEF FOR APPELLANT

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August 12, 1976

INDEX

	PAGE
Opinions Below	2
Jurisdiction	2
Constitutional and Statutory Provisions Involved	3
Questions Presented	4
Statement of the Case	4
A. Introductory Statement	4
B. Formation of the Port Authority	5
C. Port Authority Financing From 1921 Through 1961	5
D. Port Authority Involvement in Mass Transit	8
E. The 1962 Covenant	13
F. Assumption and Operation of the Hudson & Manhattan Railroad	15
G. The Use of the 1962 Covenant and its Effectiveness in Maintaining Investor Confidence in the Port Authority	18
H. The 1974 Retroactive Repeal	26
Summary of Argument	28
Argument	28
I. Chapter 25 of the Laws of New Jersey of 1974 Impairs the Obligation of the Contract Between the States and with the Port Authority's Bondholders	28
1. Retroactive repeal of the 1962 statutory Covenant cancelled a security provision valuable to bondholders	29
2. Retroactive repeal of the 1962 statutory Covenant adversely affected the secondary market for Port Authority Consolidated Bonds	38

PAGE

II. The 1962 Statutory Covenant is Secure Against Impairment by Subsequent Legislative Action 48

III. If the 1962 Statutory Covenant is Subject to the States' Police Power, Repeal of the Covenant Was Not an Exercise of the Police Power 55

IV. Even if the Retroactive Repeal of the 1962 Statutory Covenant is Considered an Exercise of the Police Power, Judicial Precedents Do Not Support its Constitutionality under the Contract and Due Process Clauses 57

1. Repeal of the 1962 Covenant was not the only way in which to meet the problems of mass transit, or pollution, or energy conservation 72

2. The existence of the 1962 Covenant, and the justifiable expectation of the continuance of the protection afforded by the Covenant, were substantial inducements to public investors purchasing Port Authority bonds 73

3. Purchasers of Port Authority bonds justifiably expected the Covenant to remain in effect as long as affected bonds remained outstanding 74

4. There have been no unforeseen or unexpected developments between 1962 and 1974 which would justify repeal of the Covenant 75

5. If the Covenant has resulted in "unexpected benefits" they are benefits to the State and not to the Port Authority's bondholders 77

6. The Covenant was not merely modified by the challenged legislation; it was totally abrogated 77

PAGE

V. Chapter 25 of the Laws of New Jersey of 1974 Violates the Fifth and Fourteenth Amendments to the United States Constitution 78

Conclusion 81

Single Appendix 1a

Table of Authorities

Borough of Fort Lee v. *United States ex rel. Barker*, 104 F.2d 275 (3d Cir. 1939) 54

Bronson v. *Kinzie*, 42 U.S. (1 How.) 311 (1843) 64, 65

Brown-Crummer Investment Co. v. *Town of North Miami*, 11 F. Supp. 73 (S.D. Fla. 1935) 54

Bush Terminal Co. v. *City of New York*, 282 N.Y. 306 (1940) 38

Chastleton Corp. v. *Sinclair*, 264 U.S. 543 (1924) 66

City of El Paso v. *Simmons*, 379 U.S. 497 (1965) 55, 61, 69, 70, 71, 72, 73, 74, 75, 77, 78

City of Little Rock v. *Community Chest of Greater Little Rock*, 204 Ark. 562 (1942) 54

Courtesy Sandwich Shop, Inc. v. *Port of New York Authority*, 12 N.Y.2d 379, *appeal dismissed*, 375 U.S. 78, *rehearing denied*, 375 U.S. 960 (1963) 15

Davis v. *Mills*, 194 U.S. 451 (1904) 74

Deutch v. *United States*, 367 U.S. 456 (1961) 38

East New York Savings Bank v. *Hahn*, 326 U.S. 230 (1945) 55, 68

Faitoute Iron & Steel Co. v. *City of Asbury Park*, 316 U.S. 502 (1942) 68, 74

Farrington v. *Tennessee*, 95 U.S. 679 (1877) 54

Fazende v. *City of Houston*, 34 F. 95 (E.D. Tex. 1888), *appeal dismissed*, 140 U.S. 689 (1890) 54

PAGE

First National Bank v. *Maine Turnpike Authority*, 153 Me. 131 (1957) 54
Fiske v. *Kansas*, 274 U.S. 380 (1927) 29
Fletcher v. *Peck*, 10 U.S. (6 Cranch) 87 (1810) 53
Green v. *Biddle*, 21 U.S. (8 Wheat.) 1 (1823) 53
Hawthorne v. *Calef*, 69 U.S. (2 Wall.) 10 (1864) 53
Home Building & Loan Association v. *Blaisdell*, 290 U.S. 398 (1934) 48, 49, 59, 60, 61, 62, 63, 64, 65
Hubbell v. *Leonard*, 6 F. Supp. 145 (E.D. Ark. 1934) 54
In re Hudson & Manhattan R.R., 174 F. Supp. 148 (S.D.N.Y. 1959), *aff'd sub nom.*, *Spitzer* v. *Stichman*, 278 F.2d 402 (2d Cir. 1960) 11
Kern-Limerick, Inc. v. *Scurlock*, 347 U.S. 110 (1954) 29
Kheel v. *Port of New York Authority*, 331 F. Supp. 118 (S.D.N.Y. 1971), *aff'd on other grounds*, 457 F.2d 46 (2d Cir.), *cert. denied*, 409 U.S. 983 (1972) 14, 15
Louisiana v. *Pilsbury*, 105 U.S. 278 (1881) 52
Louisville Joint Stock Land Bank v. *Radford*, 295 U.S. 555 (1935). 80
Lynch v. *United States*, 292 U.S. 571 (1934) 54, 72, 78
Maenhaut v. *City of New Orleans*, 16 Fed. Cas. No. 8939 (D. La. 1875) 54
McGahey v. *Virginia*, 135 U.S. 662 (1890) 54
Moore v. *Otis*, 275 F. 747 (8th Cir. 1921) 54
Napue v. *Illinois*, 360 U.S. 264 (1959) 29
Niemotko v. *Maryland*, 340 U.S. 268 (1951) 29
Norman v. *Baltimore & Ohio R.R.*, 294 U.S. 240 (1935) 53, 61
Odgen v. *Saunders*, 25 U.S. (12 Wheat.) 213 (1827) 48
Patterson v. *Carey*, 83 Misc.2d 372 (N.Y. Sup. Ct. 1975) 55
Perry v. *United States*, 294 U.S. 330 (1934) 48, 53, 54, 61
Planned Parenthood Association v. *Fitzpatrick*, 401 F. Supp. 554 (E.D. Pa. 1975) 55

PAGE

Planters' Bank v. *Sharp*, 47 U.S. (6 How.) 301 (1848) 53
Roe v. *Wade*, 410 U.S. 113 (1973) 55
Ruano v. *Spellman*, 81 Wash. 2d 820 (1973) 54
Sinking-Fund Cases, 99 U.S. 700 (1878) 71
State v. *City of Pensacola*, 40 So.2d 569 (Fla. Sup. Ct. 1949) 54
State Highway Commissioner v. *Detroit City Controller*, 331 Mich. 337 (1951) 54
Tilton v. *City of Utica*, 60 N.Y.S.2d 249 (N.Y. Sup. Ct. 1946) 78
Time, Inc. v. *Pape*, 401 U.S. 279 (1971) 29
United States v. *Louisiana*, 363 U.S. 1 (1960) 38
Veix v. *Sixth Ward Building & Loan Association*, 310 U.S. 32 (1940) 67, 79
Von Hoffman v. *City of Quincy*, 71 U.S. (4 Wall.) 535 (1866) 50, 51
W. B. Worthen Co. v. *Kavanaugh*, 295 U.S. 56 (1935) 57, 58, 59, 69
Wright v. *Hart*, 182 N.Y. 330 (1905) 78
Wolff v. *City of New Orleans*, 103 U.S. 358 (1880) 51, 52

United States Constitution Cited

Article I, Section 10 3
Fifth Amendment 3, 78, 79
Fourteenth Amendment 3, 78, 79

New York Constitution Cited

Article X, Section 7 10

PAGE

Statutes Cited

28 U.S.C. §1257(2) 3
34 Stat. 84 38
N.J.R.S. §§2A:16-50 *et seq.* 2
N.J.R.S. §§32:1-35.55(b) 2, 4
N.J.R.S. §§32:1-39, 62, 86 7
Chapter 25, Laws of New Jersey of 1974 .....3, 4, 56, 58, 81
Chapter 208, Laws of New Jersey of 1972 .....17, 25
Chapter 25, Laws of New Jersey of 1959 10
Chapter 5, Laws of New Jersey of 1931 7
Chapter 27, Laws of New Jersey of 1925 6
Chapter 130, Laws of New Jersey of 1917 5
Chapter 993, Laws of New York of 1974 2
Chapter 318, Laws of New York of 1973 .....17, 25
Chapter 1003, Laws of New York of 1972 .....17, 25

Rule Cited

Fed. R. Evid. 201(b) 38

Other Authorities Cited

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Hale, *The Supreme Court and the Contract Clause,* 57 Harv. L. Rev. 852 (1944) 79
Hochmann, Retroactive Legislation (1960) 79
Kraft and St. John, *The Contract Clause as the Guardian Against Legislative Impairment of Municipal Bondholders' Rights,* 6 Seton Hall L. Rev. 48 (1974) 80
New Jersey State Assembly Resolutions Nos. 3009, 3010 (April 24, 1975) 37

PAGE

New Jersey State Senate Concurrent Resolution No. 3016 (April 17, 1975) 37
New York Legislative Annual (1962) 13
New York State Senate Resolution No. 51 (April 15, 1975) 37
Note, 51 Va. L. Rev. 692 (1965) 79
R. Stern & E. Gressman, Supreme Court Practice (4th ed. 1969) 29

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Appellees.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

BRIEF FOR APPELLANT

Appellant appeals from the judgment of the Supreme Court of New Jersey, entered February 25, 1976, affirming the decision of the Superior Court of New Jersey, Law Division, Bergen County, which held that the unilateral retroactive cancellation of a statutory bond covenant intended for the protection of creditors of The Port Authority of New York and New Jersey was not in violation of the Contract Clause or the Due Process Clause of the United States Constitution.

Opinions Below

The decision and opinion of the Supreme Court of New Jersey is reported at 69 N.J. 253 (1976), and is set forth in the Single Appendix at pages A132-A170. The decision and opinion of the Superior Court of New Jersey, Law Division, Bergen County, is reported at 134 N.J. Super. 124 (1975), and is set forth in the Single Appendix at pages A59-A129.

Jurisdiction

Appellant initiated this action in the Superior Court of New Jersey, Law Division, Bergen County, pursuant to N.J.R.S. §§ 2A:16-50 *et seq.*, seeking a declaration that Chapter 25 of the Laws of New Jersey of 1974 contravened the Contract and Due Process Clauses of the United States and New Jersey Constitutions. Chapter 25 retroactively repealed[1] that part of the New Jersey Legislation enacted in 1962 (N.J.R.S. § 32:1-35.55(b)) which had embodied a statutory covenant between the States of New Jersey and New York and with the holders of Consolidated Bonds of the Port Authority of New York and New Jersey. The 1962 Covenant specifically limited the involvement of the Port Authority's revenues and reserves in the area of deficit rail mass transit.

After a trial in February 1975, narrowly limited to the issues of bondholder reliance on the 1962 Covenant and the extent of the damage to the secondary bond market caused by the repeal, the trial court entered an order on May 14, 1975, dismissing Appellant's complaint and declaring that Chapter 25 was constitutionally valid. Appellant appealed

1. Due to the bi-state nature of the Port Authority, valid action by both States was necessary to repeal retroactively the 1962 Covenant. On June 15, 1974, New York passed legislation similar to Chapter 25. (Ch. 993, Laws of New York of 1974).

that decision directly to the Supreme Court of New Jersey which, on February 25, 1976, affirmed the superior court's judgment, *per curiam*. The Notice of Appeal to this Court was timely filed in the Supreme Court of New Jersey on May 14, 1976; the jurisdictional statement was filed May 21, 1976, and this Court noted probable jurisdiction on June 28, 1976.

Jurisdiction is invoked pursuant to 28 U.S.C. § 1257(2), this being an appeal from a final judgment of the Supreme Court of New Jersey, the highest court of that State, holding that Chapter 25 of the Laws of New Jersey of 1974 is not repugnant to Article I, Section 10, Clause 1 of, or the Fifth and Fourteenth Amendments to, the United States Constitution.[2]

Constitutional and Statutory Provisions Involved

The Constitutional provisions which Appellant contends have been violated by the retroactive repeal of the 1962 Covenant are Article I, Section 10, Clause 1 of the United States Constitution, commonly known as the "Contract Clause", which provides in part as follows:

> "No State shall . . . pass any . . . Law impairing the Obligation of Contracts. . . ."

and the following clauses of the Fifth and Fourteenth Amendments, respectively:

> "No person shall . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation", and
>
> ". . . nor shall any State deprive any person of life, liberty, or property, without due process of law. . . ."

2. In our Jurisdictional Statement we said that the Court could decide in its discretion to note probable jurisdiction and defer consideration on the merits pending final disposition of the related action in New York (JS 3-4). A similar deferral could be appropriate prior to or following oral argument depending upon the status at that time of the New York case.

This case also involves N.J.R.S. § 32:1-35.55(b), the 1962 Covenant, set forth at pages A10-A14 of the Single Appendix, and Chapter 25 of the Laws of New Jersey of 1974, which retroactively repealed the 1962 Covenant.

Questions Presented

1. Is the 1962 statutory covenant between the States and with creditors of a state agency secure against impairment by subsequent legislative action?

2. If the statutory covenant is subject to the States' police power, was repeal of the covenant an exercise of the police power?

3. If the retroactive repeal of the statutory covenant is viewed as an exercise of the police power, was such exercise consistent with the Contract Clause and the Due Process Clause of the Federal Constitution?

Statement of the Case

A. Introductory Statement.

Appellant instituted this action in three capacities: (1) as trustee for the holders of $200,000,000 of Port Authority Consolidated Bonds, (2) on its own behalf as holder of almost $100,000,000 of Port Authority Consolidated Bonds in trust and other fiduciary accounts and (3) on behalf of the holders of over $1,600,000,000 of outstanding Consolidated Bonds. The action seeks a declaratory judgment that Chapter 25 of the Laws of New Jersey of 1974, which unilaterally and retroactively cancelled a statutory covenant between the States of New York and New Jersey and with holders of Consolidated Bonds of the Port Authority, violates the United States Constitution.

B. Formation of the Port Authority.

The Port Authority was established in 1921 by a bi-state Compact as a financially independent authority to accomplish public purpose projects with funds contributed by private investors. (A531, 532, 533). The agency was created to deal with the commercial needs of the Port of New York—the handling, distribution and transportation, not of persons, but of freight and cargo by rail, ship and motor truck. (A529-536); (Ch. 130, Laws of New Jersey of 1917). Since they organized the Port Authority with only the support of a modest initial appropriation, without any taxing power, and without any power to pledge the credit of either State, the two States dedicated themselves in their Compact to the "encouragement of the investment of capital" in the Port Authority to finance those projects authorized for Port Authority development by the two States. Public financing was to be accomplished by giving the Port Authority power to mortgage its facilities and to pledge the revenues from such facilities to secure the payment of bonds issued to private investors. (A532). Over the years since its formation the Port Authority has marketed almost $4 billion of its obligations to private investors.

Consistent with the organization of the Port Authority as a freight coordinating agency, the two States in 1922 agreed upon a Comprehensive Plan which set forth the development program initially envisioned for implementation by the agency; the Plan dealt solely with the transportation of freight by carriers and was not in any way concerned with the movement of passengers by rail or otherwise in the Port District. (A533-535).

C. Port Authority Financing from 1921 through 1961.

The superior court outlined the basic financing principles which have guided the Port Authority for over fifty years:

"Under the terms of the Compact the power to levy taxes or to pledge the credit of either state was expressly withheld from the Authority. From its inception, with the exception of monies advanced as loans by the states, the Authority was required to finance its facilities solely with money borrowed from the public and to be repaid out of the revenues derived from its operations. By reason of these financial limitations two concepts initially emerged which have played an important role in the realization of the purposes for which the Authority was created: first, the specific projects undertaken by the Authority should be self-supporting, *i.e.,* the revenues of each should be sufficient to cover its operating expenses and debt service requirements; and second, *since the Authority is a public agency over which its creditors have no direct control, the bondholders should be protected by covenants with the Authority and with the states which have ultimate control over its operations.*" (A70-71) (emphasis added).[3]

Beginning in 1952, the Port Authority adopted by resolution its present method of financing with Consolidated Bonds. The purpose of the adoption of this financing structure was to use a single vehicle for the financing of any and all purposes for which the Port Authority was or might

3. The principle of binding covenants as a means of securing investor confidence led the two States to enact a number of covenants providing protection for bondholders. None of them, except for the 1962 Covenant, has been repealed, even prospectively. For example, the two States in 1925 agreed not to authorize the construction of competitive bridges within the Port District nor to limit the right of the Port Authority to levy such charges and tolls as it deemed convenient or necessary to produce revenues adequately to fund the bonds. (Ch. 27, Laws of New Jersey of 1925, §5). The two States included similar provisions in the financing legislation for subsequent Port Authority bridges. These covenants have been so scrupulously adhered to in the past that the Tappan Zee Bridge was constructed at the widest point of the Hudson in order to avoid breaching the covenants with respect to construction of competitive bridges. (A874).

be authorized to issue bonds secured by its General Reserve Fund. (A741-743). This change in the method of financing did not result in the abandonment of the self-supporting facility principle which had governed Port Authority financing over the prior 30 years.[4] As noted by the then Executive Director of the Port Authority in his testimony before New Jersey's Farley Committee in 1961, the Port Authority never abandoned its original mandate from the States to engage only in self-supporting operations:

> "[W]e have never gone into any field before where we couldn't look a bondholder in the face and say, 'We honestly believe that we can make this self-supporting and that you'll get your money back.' We have been wrong. In the case of the motor truck terminals, certainly we were wrong. And those terminals by themselves have not earned enough and without the pooling of the general reserves wouldn't be enough." (A648; Statement of Executive Director of the Port Authority before the Farley Committee, May 5, 1961).

To be sure, many of the facilities undertaken by the agency endured years of marginal operation before becoming profitable, and some continue to show modest

4. With respect to the concept of self-supporting facilities, the initial bonds issued to the public by the Port Authority were "closed-end" bonds with the revenue from each facility pledged toward the payment of the expenses of and debt service on the bonds issued to finance that particular facility. N.J.R.S. 32:1-39, 62, 86. Surplus, if any, derived from the specific facility would be deposited in a separate reserve fund available to bondholders of the series of bonds issued to finance the facility. (A819-820). In 1931 the States directed the Port Authority to pool defined revenues, in an amount equal to ten percent of outstanding Port Authority bonded indebtedness, to the extent that such revenues were available after payment of facility expenses and debt service. This General Reserve Fund, pledged to bondholders as security for their investments, did not reach its statutory limit until 1946. (Ch. 5, Laws of New Jersey of 1931).

deficits.[5] But the principle of only embarking on ventures expected eventually to be self-sustaining remained inviolate until the agency finally developed the means to involve itself financially in deficit rail mass transit.

D. Port Authority Involvement in Mass Transit.

As early as 1922, the legislatures recognized that the Port Authority was not the appropriate agency to develop a solution to the problems of railroad passenger transit. (A569). Efforts to divert the Port Authority from its port development goals were made in 1927 and were blocked by Governor Smith of New York, one of the agency's founders, on the ground that the Port Authority was never intended to become involved in rail mass transit. (A571-574). Between 1928 and 1958 countless studies were made which emphasized the crisis nature of rail mass transit. The studies unanimously described the mass transit situation as critical, sought vast amounts of capital, and predicted substantial deficits for any mass transit operation. (A80). During this period, it was recognized that the Port Authority, consistent with its mandate to operate as a self-supporting agency of the States, could not assume financial responsibility for a solution to the problem while fulfilling its direction to solve the freight distribution problems of the Port District and maintaining the credit standing it had developed in the minds of private investors.

By the late 1950's, the mass transit situation became even more critical with the petitions of railroads to abandon Hudson River ferry service and the increasingly grave conditions of the commuter railroads and subway systems. (A545, 546, 606, 619-620). The Metropolitan Rapid

5. For example, in 1973 four of the Port Authority's facilities showed operating deficits. The combined deficits of the heliports, Erie Basin and the consolidated passenger ship terminal were $1,009,000; PATH's deficit during that year was $18,171,000. (A737).

Transit Commission concluded then that "[c]apital for . . . construction [of transit systems] . . . must be raised by a public agency and bonds issued by it must have some measure of *public guarantee* to be saleable. *Revenue bonds for transit purposes have a bad reputation in the bond market because of the financial history and condition of transit systems.*" (Stip [6] 109) (emphasis added). A 1958 bill to have the Port Authority take over and financially develop, improve and operate passenger rail transit between New York and New Jersey was vigorously opposed by the Port Authority which said:

> "This opposition is based on the conclusion of the Commissioners that: (1) It is legally, financially and contractually impossible for the Port Authority to assume the railroads' increasingly heavy deficits from commuter operations or the cost of developing a new and comprehensive rail rapid transit system; and (2) The assumption of rail transit deficits by the Port Authority, the self-supporting agency of the two States, would immediately cripple and very quickly destroy the program of the two States now under way for the continued development of their essential public port and harbor facilities, airports, and interstate arterial systems." (A586).
>
> • • •
>
> "Even if it were possible to ignore the legal and financial impossibility of the Port Authority assuming responsibility for commuter rail deficits as described above, such involvement would have a disastrous effect on Port Authority credit. This statement represents not only the considered judgment of the Commissioners of the Port Authority, but it is supported by views expressed by other responsible persons in the investment and banking field, who as a practical matter, are the controlling influence upon the receptivity of bondholders to Port Authority investment. Their views are uniform that

6. "Stip" references are to the Stipulation among Counsel Dated December 20, 1974. (R-Joint Appendix vol. iv.).

> the introduction of rapid transit deficits into the Port Authority's overall financial responsibility would have the effect of seriously impairing the Port Authority's credit standing." (A589).[7]

In 1959, the two States enacted concurrent legislation providing that upon the election by either State the Port Authority would be authorized and empowered to purchase and own railroad cars for the purpose of leasing them to commuter railroads. (Ch. 25, Laws of New Jersey of 1959). Bonds issued to purchase commuter cars would be guaranteed by the State electing to avail itself of the program, as New York did under the authority of an amendment to the New York State Constitution. (Article X, Section 7). In reliance upon New York State's commitment, bondholders purchased approximately $100,000,000 of Commuter Car Bonds which resulted in the acquisition of almost 500 air-conditioned passenger cars and 8 locomotives which are presently used on the Penn Central and Long Island Railroads. (A599). Thus New York availed itself of the Port Authority's expertise while maintaining its credit standing by authorizing the issuance of a new type of financial obligation by the Port Authority.[8]

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7. In January 1959, a joint report by two New Jersey Assembly Committees concluded that the Port Authority should not be called upon to undertake extensive rail passenger transit obligations because of the difficulty in estimating the size of any deficit operation and because of the fact that the Port Authority should only become involved in self-supporting facilities. (A593-597).

8. In connection with the commuter car program, an aide to Governor Rockefeller had first proposed that the Port Authority directly undertake financing responsibility for the purchase of commuter cars. This proposal was termed "ridiculous" by the Commissioner of Transportation and the Governor of New Jersey. (A322-323). It was seen as such a threat to the Port Authority's credit that the agency itself felt constrained to bring the proposal to the attention of its investment bankers, most of whom immediately condemned the program as destructive of the Port Authority's credit. (A299-301). Met with this reaction by the Governor of New Jersey, New Jersey's Transportation Commissioner, the Port Authority and its investment bankers, the aide to Governor Rockefeller then developed the guaranty program described above. New Jersey has not chosen to take advantage of this program.

In the early 1960's, it was proposed that, for the first time in its history, the Port Authority be directed to assume financial responsibility for a facility expected to require enormous capital expenditures and to sustain perpetual operating deficits. This was the Hudson & Manhattan Railroad, a privately owned interstate electric commuter railroad system then linking Manhattan, Newark and Hoboken. The takeover of the Hudson & Manhattan by the Port Authority was proposed at a time when the four commuter railroads operating in Northern New Jersey were sustaining total passenger operating deficits of almost $60,000,000 annually, the New York commuter railroads operating deficits of between $10,000,000 and $15,000,000 annually, and the New York City transit system operating deficits of $20,000,000 annually, exclusive of debt service charges of $87,000,000.

Of the several commuter rail systems serving the Port District, the financial prospects of the Hudson & Manhattan were by far the worst. It had been in reorganization for many years, and in 1959 the bankruptcy court approved a plan which left the railroad with enough cash to continue operations for only two years, with no funds for capital expenditures. *In re Hudson & Manhattan R.R.*, 174 F.Supp. 148 (S.D.N.Y. 1959), *aff'd sub nom., Spitzer* v. *Stichman*, 278 F.2d 402 (2d Cir. 1960).

In 1960, a special New Jersey Senate Committee under the chairmanship of Senator Farley was created to conduct a full investigation of the Port Authority to determine if

the agency was fulfilling its statutory obligations. (A605).[9] Testimony before the Farley Committee by both State and Port Authority officials was unanimous and unequivocal that it would have been impossible for the Port Authority to take over the H & M without contractual assurances adequate to protect the Port Authority's credit standing, since the necessary financing would never have been forthcoming from private investors. (A633).[10]

The Farley Committee report concluded that the solution to the problem of bondholder concern over the unlimited involvement of the Port Authority in deficit rail mass transit was "limiting by a *constitutionally-protected* statutory covenant with Port Authority bondholders the extent to which the Port Authority revenues and reserves pledged to such bondholders [could] in the future be applied to

9. During the pendency of the Farley Committee hearings, New York passed legislation directing a Port Authority takeover of the H & M without contractual assurances for the protection of bondholders. (A654). The mere enactment of this legislation, which was not concurred in by New Jersey, prompted Appellant, then the largest holder of Port Authority Bonds, to suspend all further investments in Consolidated Bonds because of the prospect that the Port Authority might be directed to undertake deficit rail mass transit obligations without limitation. (See Deposition of J. Sinclair Armstrong, Esq., at E346-E347).

10. Bondholders' fears were well founded. The four commuter railroads in New Jersey have passed through bankruptcy proceedings. The New York City Transit Authority, which operates the New York City Subway System, for its fiscal year ending June 30, 1973, had an operating deficit of approximately $175 million.

During the calendar year 1973, the Metropolitan Transportation Authority incurred total operating deficits on its commuter railroads of approximately $104 million. Adding the 1973 operating deficits of MTA's commuter railroads to those incurred by its subway system for the fiscal year ending June 30, 1973, produced a total operating deficit of $279 million. (A734).

Deficits estimated to have been incurred in 1975 by the Metropolitan Transit Authority were $450 million. In September, 1974, Mayor Beame of New York City proposed that Port Authority funds be used to help reduce such deficits. (A732, 860).

the deficits of possible future Port Authority passenger railroad facilities beyond the original Hudson & Manhattan Railroad System." (A656) (emphasis added). The superior court expressly found that "the Legislature of 1962 concluded it was necessary to place a limitation on mass transit deficit operations to be undertaken by the Authority in the future so as to promote continued investor confidence in the Authority." (A109).

E. The 1962 Covenant.

On the basis of the Farley Committee's recommendation, the Legislature of New Jersey unanimously adopted the 1962 Covenant, which provides in part:

> "The two states covenant and agree with each other and with the holders of any affected bonds, as hereinafter defined, that so long as any of such bonds remain outstanding and unpaid and the holders thereof shall not have given their consent as provided in their contract with the port authority, . . . neither the states nor the port authority nor any subsidiary corporation incorporated for any of the purposes of this act will apply any of the rentals, tolls, fares, fees, charges, revenues or reserves, which have been or shall be pledged in whole or in part as security for such bonds, for any railroad purposes whatsoever other than permitted purposes hereinafter set forth."

Governor Rockefeller, in his message approving the New York legislation embodying the Covenant, said:

> "To preserve the Port Authority's credit strength the bill includes a covenant by the two states that additional deficit financing of future railroad projects will only be undertaken within the financial limits set forth in their covenant." NEW YORK STATE LEGISLATIVE ANNUAL 324 (1962).

The States took care in the formulation of the Covenant to provide for not only the acquisition and operation of

the H & M, which the Covenant does not limit, but also to permit additional Port Authority involvement in the carriage of persons and property by rail. Thus the Covenant by its terms permits Port Authority construction of rail facilities on its bridges; it permits Port Authority involvement in freight rail facilities; it permits any mass transit involvement of the agency of which bondholders approve; it permits the agency to undertake passenger rail mass transit operations which, by federal or state financial assistance or otherwise, together with user charges, can be made self-supporting within the meaning of the Covenant. The Covenant by its terms anticipated additional Port Authority involvement in deficit rail mass transit as the agency's financial position strengthened since the Covenant's limitation is not an absolute prohibition but rather a percentage linked to and intended to expand with the Port Authority's General Reserve Fund. The Covenant's formula has no room in it today only because PATH's deficits have vastly exceeded the 1962 estimates. If the Port Authority had been permitted by the States to raise PATH fares to competitive levels there would be more than enough room within the Covenant today for the Port Authority to finance the additional rail mass transit operations which the States now wish the agency to undertake. Furthermore, no one disputes that anything which the States wish to accomplish through repeal of the Covenant can to the same extent be accomplished within the Covenant if either of the States are willing, through direct subsidies, guarantees or otherwise, to stand behind the necessary financing.[11]

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11. As Judge Tyler said in *Kheel* v. *Port of New York Authority*, 331 F.Supp. 118 (S.D.N.Y. 1971), *aff'd on other grounds*, 457 F.2d 46 (2d Cir.), *cert. denied*, 409 U.S. 983 (1972):

> "[T]he transit amendment's constraint upon non-self-supporting rail facilities does not even temporarily preclude the state legislatures from dealing with mass transit problems by other means, e.g. by enactment of subsidy programs. In these circumstances the constitutional infringement claimed is illusory." *Id.* at 122.

In 1962 and 1963, when the value of the Covenant was fresh in the minds of the legislators, the two States joined in a vigorous defense of the legislation embodying the Covenant which finally resulted in a decision on the merits by this Court that the constitutional attacks on the validity of such legislation did not present any substantial federal question. *Courtesy Sandwich Shop, Inc.* v. *Port of New York Authority*, 12 N.Y.2d 379, *appeal dismissed*, 375 U.S. 78, *rehearing denied*, 375 U.S. 960 (1963); *see Kheel* v. *Port of New York Authority, supra.*

F. Assumption and Operation of the Hudson & Manhattan Railroad.

The 1962 Covenant was effective. On September 1, 1962, the Port Authority assumed the ownership and operating responsibilities of the H & M through a wholly-owned subsidiary, the Port Authority Trans-Hudson Corporation ("PATH"), obtaining the funds necessary for the acquisition and modernization of the railroad by the successful sale of bonds to private investors. When the bonds were issued to finance the acquisition, the Commissioners of the Port Authority were able to certify, as required by resolutions authorizing each series of Port Authority Consolidated Bonds, that the acquisition and operation of the H & M would not materially impair the sound credit standing of the Port Authority, the investment status of Consolidated Bonds or the ability of the Authority to fulfill its commitments to bondholders. This certification was made possible only by the enactment of the 1962 Covenant which set statutory limits on future Port Authority involvement in rail mass transit and because PATH deficits were expected to level off at $6,575,000 during the years 1969-1991. (A677). PATH losses did not level off as expected by the Port Authority, the States and the bondholders. (A681-682). Instead, PATH's present annual losses are almost five times the anticipated amount and are all borne by the Port Authority. (A681). A principal factor contributing

to these increasing deficits has been the refusal of the Governors of New Jersey and New York to allow PATH to increase its fares to competitive levels.[12] The total cumulative operating deficit of PATH for a little over 11 years of operation amounted to over $125 million. (A683).

Governors Cahill and Rockefeller, in April 1970, jointly sought increased Port Authority participation in mass transit. The governors of the two States reached an agreement in November, 1972 providing for a PATH extension to Plainfield, New Jersey via Newark Airport,[13] direct rail service for Erie-Lackawanna riders into Penn Station, New York and direct rail service from Kennedy Airport to Manhattan. The plan anticipated a Port Authority investment of between $250-300 million out of a total projected

12. Because of the significant losses incurred by the PATH system due to increased operating costs, the Commissioners, in June 1973, voted unanimously to increase the PATH fare from 30 to 50 cents. (A685-686). Such a fare increase would have been the first one permitted to PATH in 12 years. Although neither governor exercised his veto over the proposed fare increase, Governor Rockefeller, in September 1973, in return for political support for a 1973 New York transportation bond issue, announced that the fare increase should be limited to five cents. (A685). At a meeting of Commissioners some five days after the Rockefeller announcement, all five New York Commissioners reversed themselves and unanimously voted to limit the increase to five cents. Since the New Jersey Commissioners were not, at that time, subject to the same pressures exerted upon the New York Commissioners, they voted unanimously against limiting the fare increase to five cents. In 1974, however, at the ICC hearing on a proposed 20 cent increase, Commissioner Sagner, an appointee of newly elected Governor Byrne, announced his and Governor Byrne's opposition to the increase. The Commissioners promptly voted to rescind the PATH fare increase request. While the PATH fare has remained at 30 cents for almost 16 years, an equivalent ride between Newark and Manhattan on the federally subsidized AMTRAC today is $1.00 and the present Conrail fare is $1.00.

13. A 1970 program contemplating a PATH extension to Cranford, New Jersey was amended to extend the line to Plainfield, thus eliminating competition by the Central Railroad of New Jersey and bringing the project within the terms of the 1962 Covenant. (A703, 708).

cost of $650 million. It was also proposed to eliminate the 1962 Covenant with respect to the bonds issued after the enactment of that legislation. (A706).[14]

The governors' 1972 program was enacted into law, and the legislation embodying the 1962 Covenant was amended effective May 10, 1973 by the States of New Jersey and New York (Ch. 208, Laws of New Jersey of 1972; Ch. 318, Laws of New York of 1973; Ch. 1003, Laws of New York of 1972), repealing the 1962 Covenant *only* with respect to bonds issued after the date of the legislation, in effect reaffirming the Covenant with respect to outstanding bonds.[15]

In October 1974, federal consideration of the PATH application was deferred because the State of New Jersey expressed interest in acquiring the Jersey Central Rail-

14. In December 1972, the New Jersey Senate held an information session to consider the governors' proposals. At that session, Port Authority officials stated that the Lackawanna program could be accomplished *within the terms of the 1962 Covenant* by means of a $100 million federal grant and the issuance of $50 million of Port Authority bonds. The debt service on these bonds would be financed by collecting a through charge from Lackawanna riders equal to the PATH fare existing at the time the plan was implemented. (A705). The PATH extension to Plainfield via Newark Airport was also deemed "doable" in 1972 on a self-supporting basis and thus *within the 1962 Covenant* due to an anticipated $150 million in federal grants, $50 million in Port Authority bonds, and a $40 million advance from the State of New Jersey, which would be repaid by the Port Authority from the project's net operating revenues. On August 10, 1973, the Governor of New Jersey committed the State to advance this $40 million for New Jersey's share of the capital cost of the PATH Extension Project. (A708-712).

15. The introductory statement appended to the New Jersey bill provided:

> "The bill is also designed to preclude the application of the 1962 covenant to holders of bonds newly issued after the effective date of this act, *while maintaining in status quo the rights of the holders of the bonds issued after March 27, 1962* (the effective date of the 1962 covenant legislation) *but prior to the effective date of this act.*" (A707) (emphasis added).

road as an alternative to the PATH extension. (A716). A Port Authority-New Jersey Department of Transportation task force was set up to consider all potential alternatives. It was then announced that the State of New Jersey had determined that the PATH extension to Plainfield was preferred over an acquisition by the Port Authority of the Central Railroad of New Jersey. The State also announced, however, that it had unilaterally elected to renege on its commitment to provide any part of the local share of the PATH extension financing through an advance to the Port Authority to be repaid from operating revenues of the PATH extension. The State took the position that its commitment (A709-712) was not a commitment at all. It also said that the Port Authority should provide these funds, presently estimated to require diversion of Port Authority revenues and reserves of $128.4 million. Finally, the State said that this would not be the last call on the Port Authority's revenues and reserves for deficit rail mass transit operations.

G. The Use of the Covenant and Its Effectiveness in Maintaining Investor Confidence in the Port Authority.

As noted above, the Farley Committee undertook in 1960 an extensive investigation of the Port Authority and its financial structure and concluded that a constitutionally protected statutory covenant was the only way in which the need to take over the bankrupt H & M could be harmonized with the financial community's concern over the Port Authority's future credit standing.

The then Executive Director of the Port Authority said:

> "Obviously, unless such a covenant could be established no Port Authority bonds could be sold either

> for the acquisition of the Hudson & Manhattan properties or for any other Port Authority purpose." (A85).

The then New Jersey Commissioner of Transportation, stated:

> "And it seems impossible, from all of my direct—and not through any other channels—direct contacts, to observe that money could be loaned for even the acquisition of the H&M in the event there was not some assurance that this just wasn't one bite of the cherry and that further transportation business was all to be pulled together. I think it's simply a question of whether the investor says yes or no, and at the present time my observation is the investor says no unless he has that limitation." (A86).

The Port Authority's Vice Chairman, testifying on behalf of all the Commissioners, explained why they thought that the Covenant was absolutely necessary in order to induce investors to purchase Port Authority bonds after the acquisition of the H&M:

> "We can only submit to you the unanimous view of the Commissioners of the Port Authority that there is no possibility whatsoever of borrowing the money at all without a statutory assurance to investors that any future Port Authority responsibilities in the field of commuter rail transport over and above the present and existing interstate Hudson and Manhattan railroad system will not involve a pledge of the Port Authority's General Reserve Fund.
>
> "I say to you as a New Jersey Commissioner, and with all the sincerity that I can command, that there is nothing arbitrary or doctrinaire about this conclusion. It simply represents the Port Authority's credit. My business is investment financing and I say to you gentlemen that I could not sell a single

> Port Authority bond without such an assurance. If my responsibility were on the other side of the table, I would not buy a Port Authority bond that did not contain such an assurance." (A87).

Following the enactment of the 1962 Covenant and prior to its retroactive repeal, the Port Authority issued and sold to the public $1,260,000,000 principal amount of Consolidated Bonds. In connection with these financings, the Port Authority repeatedly emphasized the importance of the Covenant's protection for bondholders to induce potential investors to purchase Consolidated Bonds. The Covenant, described to the investment community as a legally enforceable contract (A861), was discussed in detail in every Official Statement distributed in connection with the sale of Consolidated Bonds after its enactment and was discussed at information sessions held to acquaint the investment community with the protections of the Covenant and the other aspects of proposed Consolidated Bond issues. (A176-177, 179, 183-184, 683, 745-749, 861-864). Annual reports of the Port Authority after 1962 also often referred to the Covenant and its protection for Port Authority bondholders. The Covenant was discussed extensively in municipal credit reports published by Standard & Poor's, Moody's and other analysts. (A176, 177).

Purchasers of Port Authority bonds since 1962 relied in substantial part on the Covenant in making their purchases. The uncontradicted testimony of the expert witnesses established that fact beyond doubt. Each of the witnesses was an acknowledged leader in his area of the municipal bond business: John F. Thompson, investment banking and investment advisor; Lester Murphy and Austin Fitzgerald, bond dealers; and Gordon Fowler, institutional investors. Thus, Appellant supplied testimony from each of the four major areas of the municipal

bond business. There was no contradictory testimony from the State.

The trial court acknowledged that "the record supports the plaintiff's claim that investors relied on the Covenant in purchasing Authority bonds." (A110). The court concluded, however:

> "But while reliance existed, the covenant cannot be said to have been the 'primary consideration' for the purchases having been made; for no witness testified that purchases would *not* have been made without the covenant, but only that they would not have purchased or recommended the purchase of the bonds 'at the price which they were then offered.'" (A110).

Even if the trial court's characterization of the witnesses' testimony were accurate, which it was not, the distinction it attempted to draw is meaningless. To say that some persons might have been willing to purchase Port Authority bonds without the Covenant at a much higher interest rate, or a much lower price, does not affect the conclusion that the actual purchasers of the bonds made their investment decisions in reliance on the Covenant. How could the court draw a meaningful distinction between not buying Port Authority bonds at all and not buying them at the price at which they were offered? If, for example, an investor purchased a Port Authority bond at 80 but would only have paid 70 in the absence of the Covenant (see A1105), can it truly be said that the existence of the Covenant was not a "substantial inducement" or "primary consideration" for the purchase? To say that bondholders would not have purchased the bonds on the proffered terms absent the Covenant is to say that bondholders would not have purchased the bonds at all absent the Covenant, since investors were not offered a bond at one interest rate with the Covenant's protection and another bond at a much higher inter-

est rate without it. They were offered a package, and the witnesses below testified that neither they nor their customers were interested in the package without the Covenant.

The price which an investor is willing to pay for a municipal bond is of the greatest significance, since it is the single most demonstrative evidence of the value which investors place on a given security. The trial court recognized this fact earlier in its opinion when it said:

> "the interest rate fixed when the bonds are initially marketed, as well as the price of the bonds in the secondary market, will normally reflect the investor's evaluation of the underlying security of his investment. . . ." (A108).

Moreover, as stated above, the superior court's characterization of the witnesses' testimony is not accurate. For example, Gordon Fowler's testimony as to whether he would have purchased Port Authority bonds without the Covenant was as follows:

> "Q. In your purchases between 1968 [and] 1973 [in] the secondary market, were you aware of the existence of the 1962 covenant? A. Yes, I was.
>
> "Q. Did the existence of the covenant affect your decisions to purchase those bonds? A. I relied on it at the time I purchased the bonds, yes." (A1104-1105).
>
> • • •
>
> "Q. With respect to all the purchases you described [approximately $9½ million of Port Authority bonds], would you have purchased any of those bonds without the protection of the covenant? A. I can't say for certain we would not have purchased them, but if we had, it would have been at a much lower price for the given coupons." (A1105).

In addition, John F. Thompson testified that the Covenant "was an important and significant part" of what he presumed he was buying for his clients, and that he would not have recommended purchase of Port Authority bonds if he had known the Covenant would later be repealed:

> "Q. Now, specifically, Mr. Thompson, do you know whether the 1962 covenant was looked to in the purchase of Port Authority bonds since 1962? A. Oh, yes, very definitely." (A872).
>
> • • •
>
> "Q. Would you explain its relative importance since 1962 in the minds of purchasers of bonds? A. Its importance in the minds of purchasers of the bonds has been that it prevented the Port Authority from getting into a massive project producing deficits in the mass transit field or several such projects.
>
> "Q. And did you personally look to the covenant and depend on it? A. Oh, certainly. *That was—that certainly was an important and significant part of what I presumed we were buying for our clients when we purchased those bonds that I speak of.*
>
> "Q. Which were those, just to make sure it's clarified? A. This is when I was at [Scudder, Stevens & Clark] and there were at least two instances where we purchased Port Authority bonds for several clients. In each instance, the total amount was at least a million dollars of bonds." (A872-873).
>
> "Q. Assuming everything else to be equal, but if the covenant had not been enacted would those purchases have been made?
>
> • • •
>
> "The Court: Well, would you have recommended, then, the purchase of the bonds?
> "The Witness: I would not have recommended them at the price which they were then offered." (A873).
>
> • • •
>
> "Q. *If you knew that the covenant would later be repealed would you have recommended the Port*

Authority bonds during the '60s? A. *No.*" (A874) (emphasis added).

The superior court noted in two places that millions of dollars of Consolidated Bonds were purchased prior to 1962 (A108, 127), suggesting that this fact demonstrates that the 1962 Covenant was not necessary to market Consolidated Bonds *after* 1962. The court was wrong. The 1962 Covenant was not necessary prior to 1962 because, until that time, the Port Authority had never undertaken a project which, from its outset, was expected, indeed intended, to generate perpetual deficits, and never to achieve self-supporting status. Prospective purchasers had no reason to expect that the Port Authority would become involved in the morass of deficit rail operations—in fact the history and structure of the Port Authority, the Commuter Car program and the statements made in the Port Authority's Official Statements all supported the opposite conclusion.

In a similar vein the superior court suggested that the absence of "direct" Covenant protection for the Fortieth and Forty-First Series shows that the Covenant was not material to bondholders. As Appellant said in its complaint, however, the Covenant provided protection for holders of those two Series since the protection afforded by the 1962 Covenant continued as a practical matter until the year 2007. This was so stated in the Official Statement of the Port Authority used in connection with each of the two Series:

> "The statutory covenant against dilution of pledged revenues and reserves by additional passenger railroad facilities, which is discussed in the paragraph quoted above, *remains in effect with respect to affected bonds, and remains binding on*

> *the Authority although it does not apply to the bonds of the present offering.* The legislation which authorized the Port Authority to assume responsibility for the Hudson Tubes system was amended, effective May 10, 1973, by the States of New York and New Jersey (Ch. 1003, Laws of New York 1972, Ch. 318, Laws of New York 1973; Ch. 208, Laws of New Jersey 1972). The New Jersey amendment, when introduced in the New Jersey Assembly, was accompanied by a statement that the bill was intended to preclude the application of the covenant to holders of bonds newly issued after its effective date, while maintaining in status quo the rights of the holders of the bonds issued after May 27, 1962 (the effective date of the covenant legislation) but prior to the effective date of the amendment." (A19-20) (emphasis added).

It was legally impossible for this protection to be removed through the early redemption of all outstanding bonds, prior to 1982. It was economically impossible, in fact, for this protection to be removed in the foreseeable future. (A1105).

The importance of the existence of the 1962 Covenant for purchasers of the last two Series was testified to by Gordon Fowler, Secretary of Connecticut General Life Insurance Company, who has responsibility in his Company for public debt investments. Mr. Fowler stated that Connecticut General purchased $3,000,000 of the Fortieth Series in reliance on the 1962 Covenant even though it had been prospectively repealed:

> "Q. Now, with respect to the 1973 purchase of bonds, did you purchase those bonds with the knowledge of the 1973 prospective repeal of the 1962 covenant? A. Yes, I did.

"Q. Would you explain that decision? A. Well, the 40th series bonds which we purchased were not covered by the covenant. However, approximately a billion seven, thereabouts, of outstanding Port Authority bonds, were protected by the covenant and it to me was unreasonable to expect that these bonds would be fully retired in the immediate future or even the foreseeable future and therefore the 40th series bonds were indirectly protected by the covenant." (A1105).

H. The 1974 Retroactive Repeal.

On February 15, 1974, a bill was introduced in the New Jersey Legislature to repeal retroactively the 1962 Covenant. In contrast to the extensive hearings, reports and findings surrounding the passage of the 1962 Covenant and its prospective repeal in 1973, the repealer in New Jersey was enacted without legislative fact finding, without extensive contemporaneous legislative debate, without public hearings to allow opponents or bondholders to express their positions,[16] without committee reports, and without amendments to the original bill. (A763). Some legislative colloquy did take place in New York State, when Mr. Farrell, the sponsor of this repealer legislation, gave the following clearly erroneous response to a question raised by one legislator as to the wisdom of the repealer:

"Mr. Strelzin: Mr. Farrell, I am under the impression that the New York Port Authority Charter provided that if there was a shortage of funds to make necessary payments to bond holders that money would be supplied by the State of New York on application to the governmental Comptroller. Am I right, sir?

"Mr. Farrell: Both states." (A772).

16. The superior court included a lengthy discussion (A98-107) of the events preceding the 1974 repealer under the heading "Legislative History of the Repeal of the 1962 Covenant." This label is misleading because there is, in fact, no legislative history attendant upon the repeal of the 1962 Covenant. As noted, no hearings were held or other opportunity for deliberation or comment afforded in either State with respect to the proposed retroactive repeal legislation. Nor were bondholders notified of the proposed repeal, notwithstanding the fact that the bonds set forth mechanics for giving notice to bondholders.

The court below, in attempting to construct a legislative justification for the repeal, looked to the background of the *1973* legislation and to the energy crisis. Such references, however, lend no support to the notion that the Legislature acted in a deliberate fashion for purposes of protecting the welfare of the citizenry. First, the 1973 prospective repeal was a reaffirmation of the inviolability of the Covenant with respect to outstanding bonds; the States' solemn pledge was honored there. Second, it must be recalled that Governor Byrne proposed the retroactive repeal in June, 1973, well before the energy crisis.

Governor Byrne did not say one word with respect to any of the alleged justifications for the legislation upon his signing the repeal legislation on April 30, 1974. (A776-777). And Governor Wilson of New York said that the only reason for his signing the repeal legislation was to settle the controversy regarding the validity of the Covenant, not to respond to any energy, environmental or health crisis:

"It is with great reluctance that I approve a bill that overturns a solemn pledge of the State. I take this extraordinary step only because it will lead to an end of the existing controversy over the validity of the statutory covenant, a controversy that can only have an adverse effect upon the administration and financing of the Port Authority, and because it will lead to a speedy resolution by the courts of questions and issues concerning the validity of the statutory covenant." (A774).

Thus, it was with a sense of political expediency, rather than with a sense of extreme public emergency, that the Legislature passed the bill which deprived the bondholders

of the protection for which they had bargained and to which they were entitled.

SUMMARY OF ARGUMENT

The 1962 Covenant constitutes a contract as that term is used in the Federal Constitution. The States' unilateral retroactive cancellation of their pledge impaired the contract in two separate and distinct ways. First, retroactive repeal of the Covenant cancelled a security provision valuable to bondholders for which they had bargained. Second, repeal of the Covenant adversely affected the secondary market for outstanding Port Authority Consolidated Bonds.

The repeal cannot be justified as an exercise of the police power. Its enactment was not dictated by need but by a desire to alter the Port Authority's functions without assuming responsibility for the costs.

Even if the repeal were viewed as an exercise of the police power, it must be held void under the Contract and Due Process Clauses.

ARGUMENT

I.

Chapter 25 of the Laws of New Jersey of 1974 Impairs the Obligation of the Contract Between the States and with the Port Authority's Bondholders.

Two independent grounds of impairment were demonstrated below, each of constitutional proportions: (1) repeal of the covenant cancelled a security device valuable to bondholders and (2) repeal adversely affected the secondary market for the bondholders' investments. The

superior court acknowledged both grounds of impairment,[17] finding as to the first:

> "To the extent that the repeal of the Covenant authorizes the Authority to assume greater deficits for [rail mass transit] purposes, it permits a diminution of the pledged revenues and reserves and may be said to constitute an impairment of the States' contract with bondholders." (A114) (footnote omitted).

and as to the second:

> "There can be no question but that immediately following repeal and for a number of months thereafter the market price for Port Authority bonds was adversely affected. This was conclusively demonstrated by plaintiff's exhibits comparing the market price of selected Port Authority bonds, before and after repeal, with the prices of comparable bonds over the same period." (A111).

1. *Retroactive repeal of the 1962 statutory Covenant cancelled a security provision valuable to bondholders.* In concluding that the retroactive repeal of the Covenant was a proper exercise of the police power of the State, the superior court said in effect that bondholders were not injured and should be satisfied with the various tests and protections which were in effect prior to the enactment of the 1962 Covenant and which remain in effect subsequent to its

17. This Court is not bound by the superior court's findings of fact since in this case a conclusion of law as to a Federal right and a finding of fact are so intermingled as to make it necessary, in order to pass on the Federal question, to analyze the facts. *Time, Inc.* v. *Pape*, 401 U.S. 279, 284 (1971); *Napue* v. *Illinois*, 360 U.S. 264, 272 (1959); *Kern-Limerick, Inc.* v. *Scurlock*, 347 U.S. 110, 121 (1954); *Niemotko* v. *Maryland* 340 U.S. 268, 271 (1951); *Fiske* v. *Kansas*, 274 U.S. 380, 385-386 (1927); *see also* R. STERN & E. GRESSMAN, SUPREME COURT PRACTICE 142-144 (4th ed. 1969).

repeal. These are the very same tests and protections carefully considered in 1962 in the face of the agency's first entrance into the field of perpetual deficit rail mass transit; they were found to be inadequate to insure the continued acceptance of Port Authority obligations. Absent the Covenant, the States' power to direct the Port Authority into deficit rail mass transit was illusory since the necessary financing would not have been forthcoming on acceptable terms.

The superior court viewed as one of the "principal protections" for bondholders the so-called "1.3 test" contained in Section 3, Condition 3 of the Consolidated Bond Resolution. (A75). The 1.3 test, which applies *only* when a series of Consolidated Bonds[18] is issued by the Port Authority, prohibits such issuance unless the net revenues of all of the Port Authority's facilities in the best twelve of the preceding thirty-six months equal or are greater than 1.3 times the prospective debt service for the calendar year in the future in which the debt service of all outstanding and proposed new bonds secured by the General Reserve Fund would be at a maximum.

The superior court reached its conclusion that the 1.3 test provides "a principal protection" for bondholders despite the uncontradicted testimony of the Port Authority financial expert, who testified at the request of the court, to the effect that considering *only* the 1.3 test it would be possible for the Port Authority to issue bonds to finance a takeover or operation of a new facility which was certain to suffer massive operating deficits, because the expected deficits of the facility would *not* be included in the 1.3 calculation. Mr. Zarin said:

18. While the Port Authority has stated its intention to issue only Consolidated Bonds, it is possible for the agency to issue another type of obligation to which the 1.3 test would have no application.

> "Q. Mr. Zarin, does the 1.3 test really protect against deficit railroad financing by the Port Authority? The Witness: Your Honor, the 1.3 test may be protective in certain very limited cases, but as I have examined it, I do not believe that it is protective against operating deficits. It is not protective in the situation . . . outlined initially, namely the assumption of operation of a new facility and if I take protection to mean . . . protection of the security [of] bondholders, therefore it would not be protective in that situation and it would not be protective in my judgment in the event of the takeover [of] an existing facility, if one were to approach that facility with the objective of bringing that facility within what we would call the general reserve fund family." (A 1028-1029).

The superior court also relied heavily on Section 7 of the resolutions authorizing each series of Consolidated Bonds as constituting protection which bondholders should view as an adequate alternative to the 1962 Covenant. The first part of Section 7 of the series resolutions (since the 12th series) prohibits the use of any Consolidated Bond Reserve funds to pay the operating deficits of a facility acquired by the Port Authority unless such facility is acquired or constructed through the issuance of an obligation secured by the General Reserve Fund and the proceeds are used for that additional facility.

The second part of Section 7 contains the so-called "Section 7 Certification," which must be made by the Commissioners of the Port Authority at or prior to the time of the issuance of Consolidated Bonds for that facility. It provides:

> "Consolidated Bonds proposed to be issued for purposes in connection with an additional facility or a group of additional facilities in connection with which the Authority has not theretofore issued bonds which have been secured by a pledge of the General

Reserve Fund in whole or in part, may be issued, and bonds other than Consolidated Bonds proposed to be issued for purposes in connection with such an additional facility or group of additional facilities may be secured by a pledge of the General Reserve Fund in whole or in part, in each case if and only if the Authority shall certify at the time of issuance (as defined in Section 3 of the Consolidated Bond Resolution) its opinion that the issuance of such Consolidated Bonds or that such pledge of the General Reserve Fund as security for such bonds other than Consolidated Bonds will not, during the ensuing ten years or during the longest term of any of such bonds proposed to be issued (whether or not Consolidated Bonds), whichever shall be longer, in the light of its estimated expenditures in connection with such additional facility or group of additional facilities, materially impair the sound credit standing of the Authority or the investment status of Consolidated Bonds or the ability of the Authority to fulfill its commitments, whether statutory or contractual or reasonably incidental thereto, including its undertakings to the holders of Consolidated Bonds; and the Authority may apply monies in the General Reserve Fund for purposes in connection with those of its bonds and only those of its bonds which it has theretofore secured by a pledge of the General Reserve Fund in whole or in part."

The superior court correctly recognized that the Section 7 certification need only be made in connection with an issuance of bonds to finance a *new facility*, thus affording no protection to bondholders against expenditures in connection with deficit mass transit projects which do not involve new or additional facilities. As an example of the magnitude of these expenditures, the recent Newark Airport improvements, requiring the Port Authority to spend over $400,000,000, did not require a Section 7 Certification, since no additional or new facility was involved. Although these

particular improvements were not directly connected with mass transit, the method of avoiding the Section 7 certification was apparent. The legislatures of the two States proceeded to amend the definition of "air terminals" to include rail mass transit connections between Port Authority airports and New York City. (A692). The Port Authority, however, received legal opinions to the effect that, in spite of the change of definition, expenditures on the rail links would violate the Covenant. With the Covenant out of the way, a Section 7 certification would be unnecessary. It was the Covenant, therefore, which protected the bondholders, not Section 7.[20]

The Section 7 certification requires only a certification of the *opinion* of the commissioners. This *opinion* must only say that there will be no *material* impairment of the Port Authority's credit standing, or the investment status of its bonds, or its ability to fulfill its commitments to bondholders. It does not block *any* impairment; it blocks only an impairment which is material in the opinion of the Port Authority's commissioners. The 1962 Covenant does not contain the words "opinion" or "material". The superior court, which quoted extensively from a speech in 1961 by Daniel B. Goldberg, the General Solicitor of the Port Authority, ignored an important statement by Mr. Goldberg in that speech, which recognized that the Section 7 certification is nothing more than a prudent man rule:

> "To us, this [the Section 7 certification] was merely a contractual codification of an agreement and obligation which we had anyhow. . . ." (A840).

20. If, on the other hand, the rail links are held to be a new facility, it can be argued that the bondholders will not be protected by the 1.3 test, since the anticipated mass transit deficits from the new facilities would not have to be considered in the 1.3 calculation. As a result, a Section 7 certification could be made, the 1.3 test would not be effective and only the Covenant could prevent the diversion of unlimited funds.

Unlike the Section 7 certification, the 1962 Covenant requires certification of an ascertainable amount and not merely an opinion of the Commissioners of the Port Authority. This is true because at present authorization in compliance with the Covenant is limited to only "self-supporting" rail mass transit facilities in view of the existing level of PATH deficits. (A94 n. 26). "Self-supporting" is defined by the statute to mean that revenues shall at least be equal to operating and maintenance expenses and debt service. (A93).

An important and basic distinction between a Section 7 certification and a Covenant certification, which was given little weight by the superior court, is the greater precision required by the latter. The Section 7 certification permits a general certification as to whether the Port Authority can support a proposed facility by considering the projected net revenues from its whole family of facilities, whereas the 1962 Covenant certification relates solely to the projected net revenues from a single proposed facility, requiring considerably more precise a calculation and leaving considerably less leeway for error.

As Mr. Thompson testified:

> "The Section 7 certification 'Requires that the authority certify [at] the time of issuance of bonds for a new facility for the next ten years or during the life of the bonds, whichever shall be longer, in the light of its estimated expenditures; that it will not materially impair the sound credit standing of the authority or the investment status of consolidated bonds or the ability of the authority to fulfill its commitments.
>
> • • •
>
> "This [Section 7] is all in general qualitative terms, 'Materially impair the sound credit standing or the investment status of consolidated bonds or

> the ability of the Authority to fulfill its commitments.' 'Materially impair', I submit, is a phrase subject to considerable variation and interpretation particularly when it might be involved in a field where the political pressures are such as they are in the mass transit field and are such certainly as the investment community believes them to be in the mass transit field.
>
> "The Court: Now, would you compare that with the covenant requirement of the certification.
>
> "The Witness: The covenant is that they must certify that the project will, one, be self supporting." (A870-871).
>
> • • •
>
> "Now, self supporting, your Honor—although it sounds as though it can be a qualitative phrase is not, at least not in our business.
>
> "Self supporting means that the revenues shall be estimated to be at least as much as the operating expenses plus the debt service which is a mathematical requirement that does not appear in Section 7, which only requires certification that it will not materially impair and that's what I meant by more precise." (A872).

Under the Section 7 certification, the Commissioners could look to an anticipated growth in revenues of existing facilities to determine whether issuance of Consolidated Bonds for an additional facility would be a material impairment of the sound credit standing of the Port Authority. Under the Covenant test, the Commissioners would be required to examine but the single rail mass transit facility and would not be allowed to speculate regarding increased revenues from the other facilities operated by the Port Authority.

The objective importance of the Covenant as opposed to the other bondholder security provisions which remain unimpaired may be illustrated by a simple example. Prior

to the retroactive repeal of the Covenant, the non-federal share of the extension of PATH to Plainfield, New Jersey was to have been funded by an advance from the State of New Jersey. Following the retroactive repeal of the Covenant, the State of New Jersey reneged on its commitment to finance any part of the local share of the PATH extension. As a result, the Port Authority is now to bear all of the local share, presently estimated to require a diversion of pledged revenues and reserves of at least $128.4 million. (R-Ja 255-1). The 1962 Covenant would have completely blocked this diversion. The very fact that the Port Authority is proceeding with applications for Federal aid is a clear indication that no other provision of any statute or the Consolidated Bond resolution will block this diversion of pledged revenues and reserves. This pending diversion is the world of reality for bondholders and not an "abstract speculation." (See A128).

Appellees argue on the one hand that the 1962 Covenant is superfluous for bondholder protection and on the other that only by repeal of the Covenant can hundreds of millions of dollars of pledged revenues and reserves be diverted to rail mass transit. The first proposed diversion is of a total of $240,000,000 to be divided equally between the States of New Jersey and New York. (A528). In New Jersey it is expected that this amount will be applied toward the PATH extension to Plainfield, but in New York the State has not even formulated a plan to use these funds. In New Jersey the State has announced that if repeal of the Covenant is overturned by the courts the State will simply take up the slack and itself pay for the PATH extension to Plainfield. (A1128).

Appellees have sought to justify the diversion of Port Authority revenues by reference to an alleged windfall to the agency as a result of repeal:

> "The toll increase revenues, estimated at $40 million per year, will be used to finance mass transit projects that remained dormant while the Covenant stood. (See A80-84).
>
> • • •
>
> "Appellant's assertion that bondholders have lost $240 million of 'their' protection J.S. 24 fn., 18, is plainly contrary to fact. All of that money, and much more, will come from funds generated by the toll increase, not otherwise available to bondholders." (B[21] 12-13).

The toll increases upon which Appellees rely to sustain retroactive repeal of the Covenant in 1974 were instituted almost one year *after* repeal, and are not, even today, free from attack and possible reversal. The announcement of the toll increases in April, 1975 prompted these reactions:

1. The Governor of New York said that he was undecided whether to approve the increases.

2. The New Jersey Assembly and New Jersey Senate unanimously passed resolutions opposing the increases and calling for a gubernatorial veto. (New Jersey State Senate Concurrent Resolution No. 3016 (April 17, 1975); New Jersey State Assembly Resolutions Nos. 3009, 3010 (April 24, 1975)).

3. The New York State Senate passed a resolution urging Governor Carey to veto the increases. (New York State Senate Resolution No. 51 (April 15, 1975)).

4. The Governor of New Jersey said that he had not been consulted regarding the increases and then announced that he would veto the increases unless the Port Authority immediately reinstituted a commuter discount (thus encouraging additional automobile traffic), which the agency agreed to do.

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21. "B" references are to Appellees' brief in support of motion to dismiss appeal.

5. A member of Congress and other groups and individuals instituted a proceeding to challenge the increases as violative of the Federal Bridge Act of 1906 (34 Stat. 84).[21]

Appellees' repeated references to the estimated $40 million in new annual revenues from the toll increases are inexplicable in light of the fact that the Port Authority's own Annual Report[22] for 1975 flatly refutes any contention that the toll increases have materially enhanced the agency's net revenue or reserve position. The toll increases were instituted on May 5, 1975. At an alleged annual rate of $40 million in new net revenue approximately $26.7 million in new net revenue should have been realized by the Port Authority during 1975. While gross revenues increased by $48 million (versus a $37 million increase in the prior year), Port Authority revenues before debt service in 1975 increased by only $14.03 million (disregarding securities value adjustments), and surplus reserves in excess of mandated bonded debt service, which might be considered the true "surplus" of the Port Authority, rose from $23,570,000 to $23,866,000, an increase of only $296,000, not the $26,700,000 which supposedly was to be realized from the toll increases. Finally, operating expenses alone increased by over $37 million from 1974 to 1975, more than consuming any new revenues resulting from the toll increases.

2. *Retroactive repeal of the 1962 statutory Covenant adversely affected the secondary market for Port Authority*

21. This case, which if successful could result in a rollback of the toll increases, has not yet been decided. In April, 1976 the Federal Highway Administrator ordered that public hearings be held to review the toll increases.

22. A public document subject to judicial notice. *E.g., Bush Terminal Co.* v. *City of New York,* 282 N.Y. 306, 316 (1940); *see United States* v. *Louisiana,* 363 U.S. 1, 12-13 (1960); *Deutch* v. *United States,* 367 U.S. 456, 470 (1961); *cf.* Fed. R. Evid. 201(b).

Consolidated Bonds. A justifiable expectation of bondholders is that their investments will be marketable in the so-called secondary market for their obligations and will fluctuate in price according to variations in interest rates generally and in accordance with the financial prospects of the issuing agency. Implicit in this expectation is the understanding that the issuing agency or other responsible parties will not take action resulting in an adverse effect upon the market for the bonds. Retroactive repeal of the Covenant had exactly this adverse effect.

The damage to the secondary market caused by the retroactive repeal of the 1962 Covenant is evidenced by the resulting "thinness" of the markets for Port Authority bonds and the decline in prices for Port Authority bonds. Whereas Port Authority bonds prior to the repeal were readily marketable in large amounts at the generally quoted bid prices, after the repeal the market for Port Authority bonds became extremely "thin" and "sensitive" so that a sale of a large block of the bonds could not be made at the current bid price but only at a price substantially below it. (A 878, 879, 880, 887, 898). Also as a result of the repeal, the price of Port Authority bonds fell dramatically in the secondary market relative to other bonds formerly considered comparable in quality and intrinsic security. (A209, 212, 216, 883-887).[23]

The superior court found that there was no question but that immediately following repeal the market price for Port Authority bonds was adversely affected. The court

23. The secondary bond market measures materiality in hundredths of a point. A decline of 6 points represents the loss of, at the least, an entire year's interest or more on the bonds in question. For a single issue of $100 million of bonds, it represents a market loss of $6 million, and almost $2 billion of Port Authority Consolidated Bonds are presently outstanding.

went on to say, however, that the adverse effect attributable to the repeal was only temporary[24], citing the fact that the spread between Port Authority bonds and Massachusetts Port Authority bonds had narrowed by the date of trial to the same differential as had existed prior to the effective date of the repeal. The superior court also stated that there were other factors which contributed to the adverse price differential prevailing between Port Authority bonds and those of comparable issues, namely, newspaper articles critical of the Port Authority appearing in *The Wall Street Journal* and *The New York Times.* (A 110-113).

The superior court's conclusion as to the temporary nature of the damage to the secondary market is flatly contradicted by the record. That court ignored the expert testimony with respect to the "thinness" of the market resulting from repeal of the Covenant; it ignored the expert testimony explaining the convergence of the prices of the Port Authority bonds and the Massachusetts Ports; it ignored the expert testimony that the newspaper articles had no meaningful effect on the secondary market for Port Authority bonds; it ignored the fact that the dramatic increase in differential between the prices of Port Authority bonds and comparable toll road bonds has not diminished; and it ignored the unanimous testimony that, as a direct result of repeal of the Covenant, there is no longer a viable secondary market for Port Authority bonds.

Damage to the secondary market is evidenced by two separate factors: the thinness of the market[25] and the actual bid prices. The expert witnesses in fact testified that the size of the market is "more of a key factor" than

24. This conclusion ignores the fact that the market is nothing more than a compilation of sales. For every bondholder who had to sell at a depressed price, the damage certainly was permanent.

25. The three expert witnesses testified that the market for Port Authority bonds since the repeal is "unusually thin" (Mr. Thompson, A 879), "extremely thin" (Mr. Murphy, A 984, 997), and "very thin and very sensitive." (Mr. Fitzgerald, A 1093).

the quoted bid prices in measuring damage. (A 879; 997). This is particularly so in this case because the quoted bid prices for Port Authority bonds since the repeal are artificially high, because, as noted above, an attempted sale of any block of Port Authority bonds,[26] which could have been sold at the quoted price prior to repeal, would now force the quoted prices substantially lower. The volatility of the market for Port Authority bonds was dramatically demonstrated in January, 1975, by the sharp rise in prices for certain Port Authority bonds caused by purchases to cover short sales in the preceding month. Mr. Thompson testified:

> "The market has been adversely affected by the repeal. It is not possible to measure the adverse effect simply by comparing market prices I believe.
>
> "There was a time before the repeal when Port Authority bonds traded in the market very much as some of the other Authorities, major Authorities [or] State bonds do. And if a bank or insurance company with a five million dollar holding of those bonds came to a dealer and said: I want to sell these; what will you bid? He could get a bid that would be pretty much in line with the quoted market.
>
> "What we have now is a market that is usually thin. . . ." (A878-879).
>
> • • •
>
> "You could get a flow into the market by one of two things. One would be a brand new issue coming into the market. The other would be some investor who decided not to go along with this type of advice, but to sell his five or ten million dollar holdings. In my opinion in either one of those events the bid for

26. In July, 1976 the Port Authority issued and sold $100 million of Consolidated Bonds, Forty-second series. This was the first bond issue sold by the Authority since the retroactive repeal of the 1962 Covenant. It was saleable only to small "retail" purchasers since the institutions which traditionally purchased Port Authority bonds refused to purchase even at the interest rate on the issue of 8.2%, which is 2.7 percentage points above the previous issue of Port Authority bonds.

the bonds would be substantially below the market as it is quoted today." (A 879-880).

* * *

Mr. Thompson further testified that if the market were confronted with "large volume sales" of Port Authority bonds the prices for such bonds "would dip considerably further." (A 886-887). Finally, Mr. Thompson agreed with the trial court's observation:

> "The Court: With such a thin market for these bonds as you have described it after the repeal of the covenant, wouldn't the offer of a relatively small quantity of bonds have a greater effect upon the price than would otherwise be the case?
>
> "The Witness: I suspect that is true, yes." (A 898).

Mr. Murphy's testimony on this point was as follows:

> "I characterized the market as having substantial selling immediately after Governor Wilson's signing the repeal. Subsequent to that, dealers like ourselves maintained a low profile as far as long positions. The markets were extremely thin. As evidenced by what has happened in the last month [January, 1975], we have had a 20 point increase on very little supply. So when we talk about markets we're not only talking about quotations, we are talking about number of bonds traded, the size of the market which is more of a key factor than the quotes." (A 997).

The superior court referred to the testimony as to the thinness of the market (A 111), but discussed the damage to the secondary market solely in terms of the price activity of the bonds. Accordingly, its conclusion that the damage was temporary does not take into account the thinness factor. The seriousness of this oversight is compounded by the fact that, as the superior court recognized (A 108), most holders of Port Authority bonds are institutional investors (A 897-898) with large blocks of Port Authority bonds. These investors have lost the liquidity

for their bonds because of the thinness of the market resulting from the repeal of the Covenant. They have thus suffered substantial damage independent of the decline in prices, damage which the superior court simply ignored.

The superior court cited the convergence of the prices of Port Authority bonds and Massachusetts Ports at the time of the trial as support for its conclusion that the damage to the secondary market was not permanent. This assertion ignores expert testimony that explains the convergence as a technical adjustment caused by sellers covering their short positions. Messrs. Thompson and Murphy both testified that the closing of the gap between the bid prices of the two issues from late December 1974 to early February 1975 was attributable to short-term events, *i.e,* covering of short positions. (A 906, 985-987). Indeed, Mr. Murphy testified—from first hand knowledge—that the reason for the 20 point recovery of Port Authority '06's from late December 1974 to early February 1975 was that many dealers, including Barr Brothers, who had large short positions in these bonds "scrambled to try to cover their short position", resulting in a "short-term" technical situation.[27]

The superior court asserted that there were other factors which contributed to the adverse price differential between Port Authority bonds and those of comparable issues following repeal, citing in support of its statement two adverse newspaper articles. The record contradicts this conclusion. On cross-examination Appellees' counsel asked three of the expert witnesses whether the two articles could have caused the decline in the price of the Port Authority bonds and all three experts testified that the stories did not have any meaningful impact on the price of Port

27. It cost Barr Brothers in excess of 10 points to cover its short positions. (A 985-987).

Authority bonds. (A 889, 890, 891, 894, 895, 896, 897, 898, 899, 900, 1000, 1001, 1002, 1003, 1098, 1099, 1100). Moreover, while the superior court noted that Port Authority bonds suffered their sharpest decline during the one month period following *The New York Times* article, it failed to note that immediately prior to the *Times* article the spread in favor of the Massachusetts Ports was as high as 9 points, that immediately prior to *The Wall Street Journal* article the spread in favor of the Massachusetts Ports was as high as 6½ points (A209, 212), and that repeal of the Covenant was prominently featured in the *Times* article as one reason why the Port Authority had "fallen on hard times."

The superior court's opinion focused exclusively on the differential in prices between Port Authority bonds and Massachusetts Ports, but did not discuss the differential in prices between the Port Authority bonds and Indiana and Kansas Turnpike bonds, which the court also accepted as comparable issues. The fact is that the wide spread between the Port Authority bonds and the toll road bonds had not narrowed at the time of trial, and in the case of the Kansas Turnpike bonds had doubled since repeal. (A 216).

Finally and most importantly, the superior court brushed aside the unanimous and unequivocal testimony of all the witnesses that as a direct result of repeal of the Covenant there is no longer a viable secondary market for Port Authority bonds; institutional investors have rejected Port Authority bonds as a prudent investment.[29] (A 875, 876, 980, 981, 982, 983, 1092, 1093, 1105, 1106). For example, the two municipal bond dealers testified in part as follows:

29. Following the superior court's decision, Barr Brothers issued a report intended to increase investor interest in Port Authority Consolidated Bonds notwithstanding the decision. This attempt was unsuccessful; institutions continued to have no interest in the bonds and still today have no interest in the bonds. (A 1123).

Mr. Murphy:

> "Q. You spoke of investors. What effect did the repeal have on the attitude of investors towards Port bonds? A. Well, part of [our] function in the marketplace is to try to track certain relationships of various dollar bonds. We don't do any professional analysis or advice in the form of investment counseling. We merely provide markets and spread relationships, and we have found that for many years that you could, when certain spreads develop, that you could talk a customer into selling a bond and buying, let's say Ports, but we found that *subsequent to this repeal of the covenant, that most of the major institutions that we did business with, and I wouldn't say most, I don't know of any that would then buy Port Authority bonds. They crossed it off their list.*" (A 981) (emphasis added).
>
> • • •
>
> "We found that institutionally Port Authorities were no longer an acceptable exchange in that the investor, institutional-type of investor, sophisticated type investor would not any longer buy Port Authorities. If he was to sell a Kansas Turnpike or Indiana Turnpike wheretofore he would buy Ports when a certain spread relationship developed, he no longer would buy Ports.
>
> "Q. Without trying to name every one, which institutions do you refer to, what are the names of them? A. The names of the accounts?
>
> "Q. Yes. A. Well, I'd say Fireman's Fund, which is a large insurance company in San Francisco, major banks in Chicago, the First National Bank of Chicago, major banks in New York City, Bankers Trust Company, First National City Bank, insurance companies, the Connecticut General, the Hartford Fire Group and others." (A 981-982).

"Q. And those have been customers over the years as to Port bonds? A. That's correct.

"Q. You indicated in your testimony that there would be exchanges, you gave some examples. Do those have a name, those exchanges, trades? A. Swaps.

"Q. Exactly what does that entail and what are the reasons for it also? A. Well, to try to be simple, if that investor was able to sell, say, a million par value bonds at 80 and buy a very similar bond quality-wise intrinsically at 75, he might very often make the trade because from the proceeds from the sale, he is able to buy more bonds and therefore increase his income and in the case of the Ports, the spreads had widened to, in some of the trades, I recall, to 15 points or more but it was no longer a question of spread relationships. It was a turndown of the security based on how good the investor thought the intrinsic value of the Port bond had become after the repeal. (A 982-983).

Mr. Fitzgerald testified:

"Q. What effect did the legislation repealing the covenant have on your attitude and your firm's attitude towards Port bonds? A. A very negative effect in terms of that. It greatly restricted the amount of money we were willing to commit to the secondary and primary market. As soon as we became aware of the possibility of the repeal.

"I might add, that we were undoubtedly not alone in terms of this feeling. In other words, the feeling of the community was—we could determine that they were less willing to make commitments in terms of this and this had a great effect in the market in terms of the fact that the market was no longer as

viable a market as it had been prior to the repeal of the covenant. (A 1092).

• • •

"Q. What effect did the repeal have on the attitude of investors that you deal with in Port bonds?

• • •

"A. They no longer will either buy the bonds outright, nor will they buy them on swaps. This is true of customers such as Banker's Trust, United States Trust, Connecticut General, Fireman's Fund, First National Bank of Chicago, First National Bank of Louisville, and St. Louis Union. (A 1093).

The fear in the bond market engendered by the repeal of the Covenant is so pervasive that it has indirectly had a severely adverse effect on the market for other obligations of agencies of the States of New Jersey and New York.[29] (A 875, 987, 988, 1106). In fact, several large institutions have refused to purchase any bonds of any agencies of either of the two States as a result of the repeal of the Covenant. (A 875, 1106).

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29. Mr. Thompson testified in part: "The repeal of the covenant was recommended by the Governor of New Jersey approximately one week after sale of the $300 million Sports Complex issue. That issue was saleable at the time only because the Legislature had added the so-called moral obligation to its commitment.

"In my opinion—and I have heard no professional investment person who disagreed with this; in my opinion if that recommendation by the Governor had been made one week before the sale of the Sports Complex bonds instead of one week after, the bonds would not have been saleable; because the investment community was saying about the repeal of the covenant, and has said about it: If a legal covenant can be repealed by the States, what confidence can we place in their moral obligation?

"We have run onto this in an even broader field. My firm was the number two manager in a syndicate which last week underwrote $150 million and sold them of Power Authority bonds of the State of New York.

"Now the Power Authority is not dependent upon a moral obligation. It is dependent on its own revenues which are from the sale

II.

The 1962 Statutory Covenant Is Secure Against Impairment By Subsequent Legislative Action.

A State is competent to conclude contracts secure against any impairment by subsequent legislative action, even action taken under the guise of the State's police power. "[T]he right to make binding obligations is a competence attaching to sovereignty." *Perry* v. *United States*, 294 U.S. 330, 353 (1935). The 1962 statutory Covenant here in issue, a solemn undertaking between a State and its creditors, is a classic example of a contract secure against impairment.

The history of the Federal Contract Clause is instructive on the issue whether the contract here involved is secure against impairment. The reasons for its adoption have frequently been described by this Court. Widespread distress followed the Revolution, and the plight of debtors was desperate. State legislatures entered into so many unsavory schemes for the defeat of creditors and the impairment of contractual obligations that the total destruction of credit in the new nation was threatened. The restraining power of a central authority was a necessity. The need for, and general purpose of, the Contract Clause are eloquently summed up by Chief Justice Hughes in *Home Building & Loan Association* v. *Blaisdell*, 290 U.S. 398 (1934), quoting *Odgen* v. *Saunders*, 25 U.S. (12 Wheat.) 213, 354-55 (1827) (Marshall C. J., dissenting):

> "The power of changing the relative situation of debtor and creditor, of interfering with contracts, a power which comes home to every man, touches the interest of all, and controls the conduct of every individual in those things which he supposes to be proper for his own exclusive management, had been used to such an excess by the State legislatures, as to break in upon the ordinary intercourse of society, and destroy all confidence between man and man. The mischief had become so great, so alarming, as not only to impair commercial intercourse, and threaten the existence of credit, but to sap the morals of the people, and destroy the sanctity of private faith. To guard against the continuance of the evil was an object of deep interest with all the truly wise, as well as the virtuous, of this great community, and was one of the important benefits expected from a reform of the government." 290 U.S. at 428.

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of electric power. It is about as far removed from any emotional, or as far removed from the feeling I just stated as anything could be. And yet we found in several parts of the country that there were many institutional investor portfolio managers who had themselves adopted or their investment committees had adopted a rule that there be no further investment in anything in New York State or New Jersey due to the repeal of the Covenant." (A 874-875).

The Contract Clause of the Federal Constitution was a conscious and deliberate cession of power by the States to the Federal Government, intended to deal with the general distrust and doubt that was so great that the best bonds could not be sold but at a discount of 30 or even 50%. H. C. Black, An Essay on the Constitutional Prohibitions Against Legislation Impairing The Obligation of Contracts, and Against Retroactive and Ex Post Facto Laws 6-7 (1887):

> "To restore public confidence completely, it was necessary not only to prohibit the use of particular means by which it might be effected, but to prohibit the use of any means by which the same mischief might be produced. The convention appears to have intended to establish a great principle, — that contracts should be inviolable." *Id.* at 8.

Because the phrase "ex post facto laws" was not sufficiently comprehensive to ensure the protection intended by the framers, the specific provision against any law impairing the obligation of contracts was added "in order to give

perfect security to rights resting in contract." *Id.* at 9. As Madison says in THE FEDERALIST: "[L]aws impairing the obligation of contracts, are contrary to the first principles of the social compact, and to every principle of sound legislation." THE FEDERALIST, No. 43, at 310 (H. Dawson ed. 1863).

On occasion, contracts through judicial interpretation have been found to be subject to subsequent legislative impairment as a proper exercise of a State's police powers. But where, as here, the contract is between the the States and creditors of the State agency, it is settled that the States may not thereafter act in derogation of their solemn undertaking. This principle was established in a series of cases following the Civil War which established that a State may not unilaterally pass a law modifying material terms of outstanding debt obligations issued by the State or by its agencies. *Von Hoffman* v. *City of Quincy,* 71 U.S. (4 Wall.) 535 (1866), was an action to compel the City of Quincy, Illinois to levy taxes to pay unpaid interest on bonds issued in the 1850's pursuant to statutes authorizing the city to levy taxes to pay the interest. An act of the Illinois legislature passed in 1863 limited the taxing power of Quincy to pay its debts and operating expenses. This Court held that the 1863 Act violated the contract clause:

> "When the bonds in question were issued there were laws in force which authorized and required the collection of taxes sufficient in amount to meet the interest, as it accrued from time to time, upon the entire debt. But for the act of the 14th of February, 1863, there would be no difficulty in enforcing them. The amount permitted to be collected by that act will be insufficient; and it is not certain that anything will be yielded applicable to that object. To the extent of the deficiency the obligation of the contract will be impaired, and if there be nothing applicable, it may be regarded as annulled. A right without a remedy is as if it were not. For every beneficial purpose it may be said not to exist." *Id.* at 554.

Wolff v. *City of New Orleans,* 103 U.S. 358 (1880), was an action to compel the city to enforce payment of a judgment against it based on its failure to pay the principal of plaintiff's city bonds originally issued in the 1850's. An 1876 Louisiana statute repealed the legislation authorizing the levying of a special tax for payment of the bonds in effect at the time the bonds were originally issued. This Court held the 1876 Act unconstitutional notwithstanding a claim by the city that it constituted a valid exercise of the State's sovereign power to meet the emergency and chaotic financial situation which then and for several years had existed in New Orleans. Citing *Von Hoffman* v. *City of Quincy,* 71 U.S. (4 Wall.) 535 (1866), the Court said in part:

> "It is equally clear that where a State has authorized a municipal corporation to contract, and to exercise the power of local taxation to the extent necessary to meet its engagements, the power thus given cannot be withdrawn until the contract is satisfied. The State, and the corporation, in such cases, are equally bound. The power given becomes a trust which the donor cannot annul, and which the donee is bound to execute; and neither the State nor the corporation can any more impair the obligation of the contract in this way than in any other. . . . The prohibition of the Constitution against the passage of laws impairing the obligation of contracts applies to the contracts of the State, and to those of its agents acting under its authority, as well as to contracts between individuals. And that obligation is impaired, in the sense of the Constitution, when the means by which a contract at the time of its execution could be enforced, that is, by which the parties could be *obliged* to perform it, are rendered less efficacious by legislation operating directly upon

those means. As observed by the court in the case cited, 'without the remedy the contract may indeed, in the sense of the law, be said not to exist, and its obligation to fall within the class of those moral and social duties which depend for their fulfillment wholly upon the will of the individual. The ideas of validity and remedy are inseparable, and both are parts of the obligation which is guaranteed by the Constitution. The obligation of a contract 'is the law which binds the parties to perform their agreement.'" 103 U.S. at 367-68.

In *Louisiana* v. *Pilsbury,* 105 U.S. 278 (1881), this Court again reviewed the 1876 Louisiana statute which repealed the 1852 special tax act pursuant to which the relator's bonds had been issued. The 1876 statute was passed in light of a clear emergency in the State and the city:

> "It [the 1876 statute] recites in its preamble that the total debt of the city, bonded and floating, exceeds $23 million; that the taxable property of the city has become so reduced in value as to require a tax at the rate of at least five per cent per annum to liquidate the debt; that the levying of a tax at so exhorbitant a rate will render its collection impossible; that the continuation of a tax beyond the ability of the property to pay would lead to a further destruction of the assessable property of the city and to ultimate practical bankruptcy; and that the council of the city have adopted a plan for the liquidation of its indebtedness, looking to the payment of its creditors in full, 'obtaining thereby the indulgence necessary for the public well-being and the maintenance of the public honor.'" *Id.* at 298.

Notwithstanding this emergency situation, which, it should be emphasized, was clearly described in the preamble to the statute, the Court held the 1876 statute to be void as an impairment of the obligation of contracts. *See*

Hawthorne v. *Calef,* 69 U.S. (2 Wall.) 10 (1864); *Planters' Bank* v. *Sharp,* 47 U.S. (6 How.) 301 (1848); *Green* v. *Biddle,* 21 U.S. (8 Wheat.) 1 (1823); *Fletcher* v. *Peck,* 10 U.S. (6 Cranch) 87 (1810).

The next occasion for the Court to consider the special sanctity accorded to contracts between a State and its creditors or the creditors of its agencies occurred during the great depression of the 1930's, where the "gold clause" cases clearly set forth the distinction between private contracts and public contracts.

The difference in result in *Norman* v. *Baltimore & Ohio R.R.,* 294 U.S. 240 (1934), and *Perry* v. *United States,* 294 U.S. 330 (1934), illustrates this principle. In *Norman,* the Supreme Court held that Congress' power to establish a monetary system under the United States Constitution permitted Congress to alter retroactively a "gold value" clause in contracts between private parties. In *Perry,* however, decided in the same term, the majority opinion by Chief Justice Hughes, who also wrote the majority opinion in *Norman,* reached the opposite result as to the federal government's debt obligations. The Court held that such power of Congress could not retroactively change the "gold value" clause in the federal government's own bond obligations. In language appropriate to the present situation, Chief Justice Hughes said:

> ". . . The Constitution gives to the Congress the power to borrow money on the credit of the United States, an unqualified power, a power vital to the Government, — upon which in an extremity its very life may depend. The binding quality of the promise of the United States is of the essence of the credit which is so pledged. Having this power to authorize the issue of definite obligations for the payment of

money borrowed, the Congress has not been vested with authority to alter or destroy those obligations.

• • •

"There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of the Congress to alter or repudiate the substance of its own engagements when it has borrowed money under the authority which the Constitution confers." 294 U.S. at 350-351, 353-54.

Although the *Perry* case did not involve the state police power it did involve the greater police power of the Federal Government, in a nationwide emergency caused by the depression. A legislature cannot retroactively alter or repudiate the substance of such constitutionally authorized engagements if the Contract Clause is to have any meaning. *Lynch* v. *United States,* 292 U.S. 571 (1934); *McGahey* v. *Virginia,* 135 U.S. 662 (1890); *Farrington* v. *Tennessee,* 95 U.S. 558 (1877); *Borough of Fort Lee* v. *United States ex rel. Barker,* 104 F.2d 275 (3d Cir. 1939); *Moore* v. *Otis,* 275 F. 747 (8th Cir. 1921); *Fazende* v. *City of Houston,* 34 F. 95 (E.D. Tex. 1888); *Maenhaut* v. *City of New Orleans,* 16 Fed. Cas. No. 8939 (D.La. 1875); *Brown-Crummer Investment Co.* v. *Town of North Miami,* 11 F. Supp. 73 (S.D. Fla. 1935); *Hubbell* v. *Leonard,* 6 F. Supp. 145 (E.D. Ark. 1934); *City of Little Rock* v. *Community Chest of Greater Little Rock,* 204 Ark. 562 (1942); *State* v. *City of Pensacola,* 40 So. 2d 569 (Fla. Sup. Ct. 1949); *First National Bank* v. *Maine Turnpike Authority,* 156 Me. 131 (1957); *State Highway Commissioner* v. *Detroit City Controller,* 331 Mich. 337 (1951); *Patterson* v. *Carey,* 83 Misc. 2d 372 (N.Y. Sup. Ct. 1975); *Ruano* v. *Spellman,* 81 Wash. 2d 820 (1973). These cases establish the principle that where

a State elects to do so it is competent to enter into a contract with its creditors secure against subsequent impairment by the later action of the legislature. This is a sound principle; our capital markets cannot operate if municipal obligors are empowered to pick and choose among those security devices they wish to honor whenever it is deemed politically fashionable to do so.

III.

If the 1962 Statutory Covenant is Subject to the States' Police Power, Repeal of the Covenant Was Not an Exercise of the Police Power.

Even if this Court were to conclude that the 1962 statutory covenant is subject to subsequent legislative impairment by the States through an exercise of the States' police power, then the State of New Jersey has not offered any credible evidence to show that the repeal was in fact an exercise of the police power of the State.

It is not seriously disputed that the 1962 Covenant constitutes a contract within the meaning of the constitutional protection securing such agreements from subsequent legislative impairment. While legislation which is in fact an exercise of the police power is generally presumed reasonable (*e.g., City of El Paso* v. *Simmons,* 379 U.S. 497, 508-509 (1965); *East New York Savings Bank* v. *Hahn,* 326 U.S. 230, 232-233 (1945)), Appellees did not present any credible evidence that the repeal was in fact an exercise of the State's police power or was enacted to express some legitimate State interest. *See Roe* v. *Wade,* 410 U.S. 113, 155 (1973); *Planned Parenthood Association* v. *Fitzpatrick,* 401 F.Supp. 554, 564 (E.D. Pa. 1975). It is clear that repeal of the Covenant was in fact the result of a change in attitude by politicians in both States with respect to the mission

of the Port Authority—the result of a vague and inaccurate impression that the agency was intended to solve the passenger transportation as well as the freight transportation difficulties of the Port District. This change in attitude, based upon a mistaken reading of the Port Authority's Compact and ignorance of the history of the Port Authority, clearly cannot justify the repeal of the Covenant on the grounds that the repeal legislation is an exercise of the police power of the State. Appellees have constructed an imaginary case for an exercise of the police power which case, however, has no real existence. No one disputes the coincidental coexistence of energy and environmental problems at the time the Covenant was retroactively repealed. Appellant stipulated to this. But to say that the Legislature made reference to such concerns when it passed Chapter 25 of the Laws of 1974 is to equate coincidence with reality. This is reality:

1. Repeal was the culmination of a campaign pledge made by Candidate Byrne in June, 1973, six months before the energy crisis which is now used to justify repeal.

2. The legislation itself is silent as to any supposed emergency as a reason for its existence. If the legislature in fact had any energy or environmental concern in mind when they repealed the Covenant, surely there would have been some reference to it.

3. A review of the extraordinary publicity accorded the repeal shows only a handful of references to any connection between repeal and any energy or environmental problem. No legislative or public hearings were held.

4. Governor Byrne did not mention any energy or environmental problem when he signed the repealer.

5. Governor Wilson said that he signed the repealer with "great reluctance" and only to put the issue of the Covenant's validity before the courts.

This is not a police power case at all. It is a test case to determine whether a statutory agreement between a State and creditors of a State agency can arbitrarily be cancelled whenever deemed expedient by the politicians then in office.

IV.

Even If the Retroactive Repeal of the 1962 Statutory Covenant is Considered an Exercise of the Police Power, Judicial Precedents Do Not Support its Constitutionality under the Contract and Due Process Clauses.

The superior court erred in holding that the repeal of the Covenant was justified as an exercise of the State's police power. It conceded that repeal "permits a diminution of the pledged revenues and reserves and may be said to constitute an impairment of the State's contract with the bondholders." (A 114).

The holding that the repeal was an exercise of the police power and, therefore, constitutional, notwithstanding the conceded impairment, is erroneous and is based on a misapplication and mis-interpretation of language derived from *W. B. Worthen Co.* v. *Kavanaugh,* 295 U.S. 56 (1935). The superior court stated the test of constitutionality as follows:

> "Conceding the existence of some impairment of bondholder security as a result of the repeal, has the action of the States destroyed the quality of their security as an 'acceptable investment for a rational investor'?" (A 126-127).

Kavanaugh involved bonds issued by an Arkansas municipal improvement district secured through mortgage benefit assessments provided by statute. The challenged legislation substantially reduced interest and penalties payable on default, greatly extended the time in which the property could be sold on default, and permitted the property owner to remain in possession, with an extended right of redemption, without accounting for rents. Mr. Justice Cardozo, speaking for this Court, held that in enacting the challenged legislation, the legislature had "put restraint aside" and "[w]ith studied indifference to the interests of the mortgagee or to his appropriate protection they have taken from the mortgage the quality of an acceptable investment for a rational investor." *Id.* at 60. He specifically noted that the changes wrought by the challenged legislation were so substantial that the State had transgressed the "outermost limits" of constitutional bounds.

> "In the books there is much talk about distinctions between changes of the substance of the contract and changes of the remedy. . . . The dividing line is at times obscure. There is no need for the purposes of this case to plot it on the legal map. Not even changes of the remedy may be pressed so far as to cut down the security of a mortgage without moderation or reason or in a spirit of oppression. Even when the public welfare is invoked as an excuse, these bounds must be respected. . . . *We state the outermost limits only. In stating them we do not exclude the possibility that the bounds are even narrower.* The case does not call for definition more precise. A catalogue of the changes imposed upon this mortgage must lead to the conviction that the framers of the amendments have put restraint aside. With studied indifference to the interests of the mortgagee or to his appropriate protection they have taken from the mortgage the quality of an acceptable investment for a rational investor. *Id.* at 60 (emphasis added).

The superior court adopted these "outermost limits" as its sole standard for determining the constitutionality of the 1974 Legislation. According to the superior court's rationale, any impairment by the State which falls short of the "outermost limits," is constitutionally valid. What to this Court was an unconstitutional maximum has been turned into a required minimum.

If only those acts of the State which resulted in the destruction of a contract as an acceptable investment were constitutionally impermissible, virtually no covenant or combination of covenants in a bond resolution or statute would be safe from abrogation. There are innumerable covenants and provisions in bond resolutions and statutes, the abrogation of which would not "destroy" the bond's security, but which obviously would result in material impairment of it. Even measured by the "outermost limits" of *Kavanaugh* repeal of the Covenant is constitutionally offensive. There the basic legislation remained; here the States' pledge has been unilaterally wiped from the statute books. Further, the "rational investors" who testified below all said that to them and their customers Port Authority bonds without the Covenant were not an acceptable investment. (See *supra* pp. 22-26).

The superior court held:

> "The line of demarcation between *Blaisdell* and *Kavanaugh* may be expressed as one of degree: The state's inherent power to protect the public welfare may be validly exercised under the Contract Clause even if it impairs a contractual obligation *so long as it does not destroy it.*" (A 121) (emphasis added).

This extreme view is not held by this Court. It cannot be concluded that the framers of the Constitution of the United States meant "destroy" when they said "impair."

Home Building & Loan Association v. *Blaisdell,* 290 U.S. 398 (1934), is cited by the superior court in support of its position as illustrative of an impairment short of destruction and, therefore, constitutional. *Blaisdell,* however, is

distinguishable from this case, and in no way a precedent against it.

In *Blaisdell,* the Minnesota Mortgage Moratorium Law which took effect on April 18, 1933, provided that sales could be postponed and periods of redemption extended only during the emergency declared to exist. In no event was the act to remain in effect after May 1, 1935, and any postponement of a sale or period of redemption would have to expire on that date. The court could also direct that during any extension the mortgagor must pay all or a reasonable part of the property's income or fair rental value for the payment of taxes, insurance, interest and mortgage indebtedness, thus giving the institutional lenders, who had no real interest in actual possession, the practical equivalent of possession. The state court upheld the statute as an emergency measure. It conceded that the obligations of the mortgage contract were impaired, but decided that, notwithstanding the Contract Clause of the Federal Constitution, the statute was within the police power of the state by reason of the public economic emergency which the legislature had found to exist. It relied upon the preamble and first section of the statute, which described the existing emergency in terms which it held justified the temporary relief afforded by the statute.

Blaisdell is distinguishable from this case on many grounds. The contract involved was a private contract; a state of emergency was found by the legislature and expounded in the statute; the impairment was temporary; the relief was granted upon reasonable conditions; and the impairment did not affect the integrity of the obligation.

As noted above, there have been cases in which the impairment of a contract between private parties by a state legislature in the exercise of its police power has been permitted. It is settled, however, that a state may not impair its own contract with its citizens. The only exception to this rule is *City of El Paso* v. *Simmons,* 379 U.S. 497 (1965), which involved a unique set of facts and which is distinguishable on other grounds. (See *infra* pp. 72-78). The position of Chief Justice Hughes on this point is interesting. He wrote the majority opinion in *Blaisdell* in 1934 and in *Norman* v. *Baltimore & Ohio R.R., supra* and *Perry* v. *United States, supra,* the "gold clause" cases, on the same day in 1935. Two of these cases, *Blaisdell* and *Norman,* involved private contracts, and the impairment by the State was permitted; *Perry* involved impairment by Congress of its own contract, and the attempt was held to be unconstitutional.

After nine introductory clauses expounding the emergency conditions in the state, the challenged Minnesota Mortgage Moratorium Law in *Blaisdell* provided:

> "Section 1. *Emergency Declared to Exist.* — In view of the situation hereinbefore set forth, the Legislature of the State of Minnesota hereby declares that a public economic emergency does exist in the State of Minnesota. 290 U.S. at 422 n.3.

The state court held that there were sufficient facts upon which to base such a finding, and this Court approved. Chief Justice Hughes devoted four pages and voluminous footnotes in his opinion (*Id.* at 420-424) to the legislative finding of a state of emergency and emphasized the importance of such a finding in his decision of the case. The contrast is marked between the exhaustive treatment of the crisis in *Blaisdell* and the absolute and complete silence in the repeal legislation here.

Chief Justice Hughes stressed nothing more in his opinion than the temporary nature of the impairment. He said in part:

> "In determining whether the provision for this *temporary* and conditional relief exceeds the power

> of the State by reason of the clause in the Federal Constitution prohibiting impairment of the obligations of contracts, we must consider the relation of emergency to constitutional power, the historical setting of the contract clause, the development of the jurisdiction of this Court in the construction of that clause, and the principles of construction which we may consider to be established." *Id.* at 425 (emphasis added).

and again:

> ". . . But it does not follow that conditions may not arise in which a *temporary* restraint of enforcement may be consistent with the spirit and purpose of the constitutional provision and thus be found to be within the range of the reserved power of the State to protect the vital interests of the community. It cannot be maintained that the constitutional prohibition should be so construed as to prevent limited and *temporary* interpositions with respect to the enforcement of contracts if made necessary by a great public calamity such as fire, flood, or earthquake. . . ." *Id.* at 439 (emphasis added).

and again:

> ". . . And if state power exists to give *temporary* relief from the enforcement of contracts in the presence of disasters due to physical causes such as fire, flood or earthquake, that power cannot be said to be non-existent when the urgent public need demanding such relief is produced by other economic causes. . . ." *Id.* at 439-440 (emphasis added).

He concluded:

> "5. The legislation is *temporary* in operation. It is limited to the exigency which called it forth. While the postponement of the period of redemption from the foreclosure sale is to May 1, 1935, that period may be reduced by the order of the court under the statute, in case of a change in circumstances, and the operation of the statute itself could not validly outlast the emergency or be so extended as virtually to destroy the contracts." *Id.* at 447 (emphasis added).

In *Blaisdell,* this Court upheld the impairment because the relief was granted on reasonable conditions, the integrity of the obligations remained intact and the end to be accomplished was legitimate.

The Minnesota legislation required that sales could only be postponed, and rights to redemption extended, during the emergency or for two years, whichever period was shorter. It also provided that the mortgagor must pay rent during the extension period—the practical equivalent of possession. Chief Justice Hughes said:

> "The statute does not impair the integrity of the mortgage indebtedness. The obligation for interest remains. The Statute does not affect the validity of the sale or the right of a mortgagee-purchaser to title in fee, or his right to obtain a deficiency judgment, if the mortgagor fails to redeem within the prescribed period. Aside from the extension of time, the other conditions of redemption are unaltered. While the mortgagor remains in possession he must pay the rental value as that value has been determined, upon notice and hearing, by the court. The rental value so paid is devoted to the carrying of the property by the application of the required payments to taxes, insurance, and interest on the mortgage indebtedness. While the mortgagee-purchaser is debarred from actual possession, he has so far as rental value is concerned, the equivalent of possession during the extended period." *Id.* at 425.

Compare these reasonable conditions for the granting of relief in *Blaisdell* to this case. In the first place, the relief here runs to the State which passed the repealer. The State has an obligation to provide adequate mass transit

for its citizens. This is expensive. By diluting bondholders' security, the State relieves itself of part of the cost. In other words, the recipients of the benefits from the impairment are not poverty-stricken, desperate farmers in the depths of the Depression, but the sovereign States of New Jersey and New York! In the second place, as opposed to the reasonable conditions in *Blaisdell,* in this case there are no conditions—the impairment is absolute, complete and everlasting. This is a very important distinction because it means that the case at bar is controlled by *Bronson* v. *Kinzie,* 42 U.S. (1 How.) 311 (1843) rather than by *Blaisdell.* Chief Justice Hughes distinguished *Bronson* as follows:

> ". . . In *Bronson* v. *Kinzie,* 1 How. 311, state legislation, which had been enacted for the relief of debtors in view of the seriously depressed condition of business, following the panic of 1837, and which provided that the equitable estate of a mortgagor should not be extinguished for twelve months after sale on foreclosure, and further prevented any sale unless two-thirds of the appraised value of the property should be bid therefor, was held to violate the constitutional provision. It will be observed that in the *Bronson* case, aside from the requirement as to the amount of the bid of the sale, the extension of the period of redemption was unconditional, and there was no provision, as in the instant case, to secure to the mortgagee the rental value of the property during the extended period. *McCracken* v. *Hayward,* 2 How. 608, *Gantly's Lessee* v. *Ewing,* 3 How. 707, and *Howard* v. *Bugbee,* 24 How. 461, followed the decision in *Bronson* v. *Kinzie;* that of *McCracken,* condemning a statute which provided that an execution sale should not be made of property unless it would be two-thirds of its value according to the opinion of three householders; that of *Gantly's Lessee,* condemning a statute which required a sale for not less than one-half of the appraised value; and that of *Howard* making a similar ruling as to an unconditional extension of two years for redemption from foreclosure sale. . . ." 290 U.S. at 431-32 (footnote omitted).

The dissent had this to say about the distinction between *Bronson* and *Blaisdell:*

> ". . . this postponement, [of the period of redemption] if it had been unconditional, undoubtedly would have constituted an unconstitutional impairment of the obligation. This court so decided in *Bronson* v. *Kinzie, supra,* where the period of redemption was extended for a period of only twelve months after sale under the decree; in *Howard* v. *Bugbee, supra,* where the extension was for two years; and in *Barnitz* v. *Beverly, supra,* where the period was extended for eighteen months. Those cases we may assume, still embody the law, since they are not overruled.
>
> "The only substantial difference between those cases and the present one is that here the period of extension of redemption and postponement of the creditors ownership, is accompanied by the condition that the rental value of the property shall, in the meantime, be paid." *Id.* at 480-481.

Reasonable conditions may involve not only rental payments during the period of postponement, but also requirements that the impairment be temporary and confined to the period of emergency.

Chief Justice Hughes said:

> "Whatever doubt there may have been that the protective power of the State, its police power, may be exercised—without violating the true intent of the provision of the Federal Constitution—in directly preventing the immediate and literal enforcement of contractual obligations, by a *temporary and conditional restraint,* where vital public interests would otherwise suffer, was removed by our decisions relating to the enforcement of provisions of leases during a period of scarcity of housing." *Id.* at 440. (emphasis added).

In discussing the lease cases, the Court went on to observe that the relief afforded there was temporary and conditional, that it was sustained because of the emergency due to scarcity of housing, and that provisions were made for reasonable compensation to the landlord during the period he was prevented from regaining possession. The Court also decided that while the declaration by the legislature as to the existence of the emergency was entitled to great respect, it was not conclusive; and, further, that a law depending upon the existence of an emergency or other certain state of facts to uphold it may cease to operate if the emergency ceases or the facts change even though valid when passed. It is always open to judicial inquiry whether the exigency still exists upon which the continued operation of the law depends. *Id.* at 441-442. *Chastleton Corp.* v. *Sinclair,* 264 U.S. 543, 547, 548 (1924).

If it can be said in the case at bar that the ends to be accomplished are improvement in mass transit, decrease in air pollution and conservation of energy, it must be granted that they are legitimate. But they are not, in fact, the end sought by this legislation. They are after the fact arguments seized upon by Appellees to defeat this lawsuit. The true end of the repeal legislation was to siphon off imaginary Port Authority surplus into mass transit, thus relieving the State of the necessity of finding the funds elsewhere. The State found it more convenient to repudiate its word and invade the bondholders' security than to raise the money through unpopular taxation.

In addition, the relief must be appropriate. The crises allegedly influencing the legislators involved energy and pollution. These problems can only be attacked by reducing vehicular traffic partially through the improvement of mass transit. But the improvement of mass transit does not require violation of the States' covenant with bondholders. Mass transit is not only the responsibility of the

States; it is a responsibility the States agreed not to pass on to the bondholders. As discussed elsewhere, there are a multitude of ways for the States to bear this burden without violating the Federal Constitution.

Enough has been said to make clear that the integrity of the obligation from the State to the bondholders has been impaired. Appellees have argued below that the bondholders are only entitled to payment of interest and the repayment of principal, and the ability of the Port Authority to do both allegedly has not been impaired. It must be an alarming thought to bondholders in this country that all the covenants and protection in a bond are worthless if the obligor decides that principal and interest payments can be made without one or more of them. The decision, of course, is made unilaterally by the obligor!

The bondholders are dependent upon Port Authority revenues. They thought they were safe from inroads from additional perpetual mass transit deficits. Suddenly, without warning or notice, the Covenant is repealed and their only protection is the grossly inadequate 1.3 test and Section 7 of the Series resolutions which puts them at the mercy of an opinion of Commissioners who, when last called upon in connection with the PATH takeover, were wrong by a factor of five. Already, as stated above, it is planned to divert $240,000,000, with no end in sight.

The other depression cases support this interpretation of the Contract Clause. For example, in *Veix* v. *Sixth Ward Building & Loan Association,* 310 U.S. 32 (1940), the State's building and loan associations were faced with insolvency and statutes extending the withdrawal rights of certificate holders were upheld on the theory that the certificate holders had purchased their shares while statutory requirements were in effect and were subject to further legislation on the same topic. The Court expressly found that the weakness in the State's financial system caused by the emergency of the depression remained.

In *Faitoute Iron & Steel Co.* v. *City of Asbury Park,* 316 U.S. 502 (1942), plaintiff alleged that the New Jersey Municipal Finance Act, adopted in 1931, effected an unconstitutional impairment of the obligation of contract. Under the Act, plans were formulated for the adjustment or composition of the claims of creditors of insolvent municipalities in New Jersey. These plans were binding on all creditors if approved by the municipality, by a Municipal Finance Commission and by creditors representing 85 percent of the indebtedness affected, and if, in addition, they were adopted by the New Jersey Supreme Court. In 1935, the City of Asbury Park became insolvent and availed itself of the provisions of the Act. A plan for the refunding of its bonded debt was finally approved and put into operation in 1938. The plaintiffs were holders of defaulted bonds acquired prior to the adoption of the Act. Under the plan, plaintiffs' bonds were converted into new bonds maturing at a later date and bearing a lower rate of interest than the original bonds. Plaintiffs alleged that the Act under which the plan was formulated was in violation of the Contract Clause.

This Court found that there had been no impairment of contract, noting in its opinion that the Constitution was "'intended to preserve practical and substantial rights . . .'." 316 U.S. at 514. The Court's decision was clearly motivated by the fact that without the adoption of the plan the plaintiffs would not have received as much on account of their bonds:

> "Impairment of an obligation means refusal to pay an honest debt; it does not mean contriving ways and means for paying it." *Id.* at 511.

In *East New York Savings Bank* v. *Hahn,* 326 U.S. 230 (1945), moratorium legislation similar to that in *Blaisdell* had been enacted by New York in 1933 and had been extended year by year to 1943. The extensions had been

prompted by joint legislative committees which made thorough studies and recommended continuance of the moratorium. The 1941 extension had added to the requirements of payment of taxes, insurance and interest, the amortization of principal at the rate of 1% per annum. The 1943 legislation increased the amortization rate and was enacted only following another legislative committee's recommendation.

> "The whole course of the New York moratorium legislation shows the empiric process of legislation at its fairest: frequent reconsideration, intensive study of the consequences of what has been done, readjustment to changing conditions, and safeguarding the future on the basis of responsible forecasts. The New York Legislature was advised by those having special responsibility to inform it that "the sudden termination of the legislation which has dammed up normal liquidation of these mortgages for more than eight years might well result in an emergency more acute than that which the original legislation was intended to alleviate.'" *Id.* at 234-35.

In addition to its misconception of *Kavanaugh,* the superior court misapplied *City of El Paso* v. *Simmons,* 379 U.S. 497 (1965), the case "upon which the defendants place greatest reliance." (A 122).

Briefly, the facts in *El Paso* were as follows: In 1910, the State of Texas sold public land to plaintiff's predecessor in title in accordance with a State policy of selling such lands to raise funds for public schools. The purchase money mortgage contract was extremely favorable to the purchaser. In practice, the payment of principal was periodically postponed and, in fact, was never called due. The State retained a right of forfeiture if the owner failed to pay interest, but the owner or his vendees were entitled to reinstatement, provided no rights of third persons had intervened. The right to reinstatement was

therefore defeasible, and the State always had pursued a policy of quick resale of the forfeited lands to a third party, thus cutting off the right to reinstatement. In 1941, legislation was enacted providing that the right of reinstatement had to be exercised within five years from the date of forfeiture or from the effective date of the act, whichever was later. Plaintiff, who filed his application for reinstatement more than five years after the date of forfeiture, filed suit to determine title to the land, claiming that the 1941 legislation violated the Contract Clause.

The 1941 remedial statute was essentially prospective in its effect; indeed, it is this circumstance which led this Court to its final conclusion:

> "The measure taken to induce defaulting purchasers to comply with their contracts, requiring payment of interest in arrears within five years, was a mild one indeed, hardly burdensome to the purchaser who wanted to adhere to his contract of purchase, but nonetheless an important one to the State's interest." 379 U.S. at 516-517.

In the present case the Port Authority bondholders, in direct contrast, were holders of an absolute right under the 1962 Covenant, applicable during the stated period the bonds are outstanding and not defeasible by subsequent action by the State.

In *El Paso*, this Court emphasized the conjectural nature of the reinstatement rights there involved,[31] and carefully carved out a narrow exception to the rule that a State may not repudiate its own obligations through the exercise of its police power. The superior court did not deal with this

31. The Court stated: "*Assuming* the provision for reinstatement after default to be part of the State's obligation, we do not think its modification by a five-year statute of repose contravenes the Contract Clause." *Id.* at 508 (emphasis added). The Court denigrated the value of the unlimited reinstatement right throughout its opinion. See *id.* at 506 n. 9, 509, 514-15.

Court's careful explanation of the extraordinary circumstances which existed in *El Paso*. As shown below, the factors and circumstances on which this Court relied in *El Paso* to justify the use of the police power to repudiate the State's own obligations are not found in the present case.

The Court in *El Paso* upheld the modification of the right to reinstatement only after finding the existence of *all* of the following factors:

(a) The challenged legislation was the only means to accomplish the purpose of the legislature to safeguard the vital interests of the people. *Id.* at 512-13;

(b) The right to reinstatement was not a substantial inducement to buyers entering into the contracts. *Id.* at 514;

(c) The buyers could not, and did not, expect the unlimited right to reinstatement to be of everlasting effect. *Id.*;

(d) There had been a substantial change in circumstances during the more than 40 year period between the enactment of the legislation embodying the right to reinstatement and the enactment of the legislation modifying that right. *Id.* at 511, 516;

(e) Unforeseen and unexpected developments conferred considerable advantages on the buyer and costly and difficult burdens on the State. *Id.* at 515;

(f) The challenged legislation merely restricted buyers to those gains reasonably to be expected from the contracts. *Id.*; and

(g) The right to reinstatement was merely modified, not abrogated and the five-year statute of repose was a mild measure "hardly burdensome to the purchaser who wanted to adhere to his contract of purchase. . . ." *Id.* at 516-517.

1. Repeal of the 1962 Covenant was not the only way to meet the problems of mass transit, or pollution, or energy conservation.

In *El Paso* the State of Texas enacted the challenged legislation only after it had unsuccessfully attempted to alleviate the problems directly created by the right to reinstatement by other legislation. *Id.* at 512-13.[32] Only after this legislation proved unsuccessful did the State of Texas enact the challenged legislation by which the State could "restore confidence in the stability and integrity of land titles and * * * enable the State to protect and administer its property in a businesslike manner." *Id.* at 511-12.

In the present case, the State abrogated the Covenant, not because it was the only means to meet mass transit and related problems, but purely and simply in order to avoid having to pay for the solutions to those problems. A desire to "lessen government expenditure" is not a sufficient excuse for abrogating contracts. *Lynch* v. *United States*, 292 U.S. 571, 580 (1934):

> "Punctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors. No doubt there was in March, 1933, great need of economy. In the administration of all government business economy had become urgent because of lessened revenues and the heavy obligations to be issued in the hope of relieving widespread distress. Congress was free to reduce gratuities deemed excessive. But Congress was without power to reduce expenditures by abrogating contractual obligations of the United States. To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an act of repudiation. 'The United

32. "The attempts to assure some stability in land sales through repurchase acts, allowing delinquent owners a preferential right to buy forfeited land at a reappraised value, and, under one act, without payment of accumulated interest in arrears, proved unsuccessful, and expensive." *Id.* at 512-13.

> States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen.' *Sinking-Fund Cases*, 99 U.S. 700, 719."

In the instant case, there are numerous ways in which the State could deal with the problems of mass transit, pollution and energy conservation, utilizing the expertise and management of the Port Authority but without repealing the Covenant. As one example, the Port Authority could assist in providing the State of New Jersey with efficient commuter railroads if the State would only agree to stand behind the necessary financing, as the State of New York elected to do in connection with the Port Authority's Commuter Car Program. The stumbling block is not the Covenant; it is the State's desire to use as its own the revenues and reserves of the Port Authority pledged to bondholders.

2. The existence of the 1962 Covenant, and the justifiable expectation of the continuance of the protection afforded by the Covenant, were substantial inducements to public investors purchasing Port Authority bonds.

In *El Paso* the Court said that (a) the buyer was not "substantially induced" to enter into his contract on the basis of a defeasible right to reinstatement, and (b) the buyer did not interpret the reinstatement right "to be of everlasting effect." *Id.* at 514.

As to the issue of "substantial inducement," the trial court found that "the record supports the plaintiff's claim that investors relied on the Covenant in purchasing Authority bonds," (A 110) although concluding that the Covenant was not a "primary consideration" for the purchases. The refutation of this theory is set forth above (*supra* pp. 21-24).

3. Purchasers of Port Authority bonds justifiably expected the Covenant to remain in effect as long as affected bonds remained outstanding.

In *El Paso* the Court found that the buyer did not interpret his right to be of everlasting effect. 379 U.S. at 514. In determining whether the right was "practical and substantial" rather than theoretical, the Court also asked whether there was an expectation the right would continue to exist:

> "We do not believe that it can seriously be contended that the buyer was substantially induced to enter into these contracts on the basis of a defeasible right to reinstatement in case of his failure to perform, *or that he interpreted that right to be of everlasting effect.* At the time the contract was entered into the State's policy was to sell the land as quickly as possible, and the State took many steps to induce sales. [Citation omitted]. Thus, for example, the Land Commissioner was required to reclassify forfeited lands by the next sale day and to publicize widely the forfeiture and sale. [Citation omitted]. This policy clearly indicates that the *right of reinstatement was not conceived to be an endless privilege conferred on a defaulting buyer.* A contrary construction would render the buyer's obligations under the contract quite illusory while obliging the State to transfer the land whenever the purchaser decided to comply with the contract, all this for a nominal down payment. We, like the Court in *Faitoute Iron & Steel Co.* v. *City of Asbury Park,* 316 U.S. 502, 514, believe that '[t]he Constitution is intended to preserve practical and substantial rights, not to maintain theories.' *Davis* v. *Mills,* 194 U.S. 451, 457." *Id.* at 514-15 (emphasis added).

The superior court ignored the fact that Port Authority bondholders justifiably expected the Covenant to remain in effect so long as "affected bonds" remained outstanding. A key provision of the Covenant is that "so long as any of

such [affected] bonds remain outstanding and unpaid and the holders thereof shall not have given their consent as provided in their contract with the Port Authority" the Covenant would endure. The Covenant was described by the Farley Committee (A 656), and the Port Authority as a legally enforceable, constitutionally protected agreement (A 861, 939), and professional investors and advisors believed that the Covenant was "protected by the Impairment Clause of the Constitution." (A 879).

4. There have been no unforeseen or unexpected developments between 1962 and 1974 which would justify repeal of the Covenant.

This Court in *El Paso* emphasized the dramatic, historical changes which had occurred in Texas between 1895, when the original legislation was enacted, and four and one-half decades later, when the challenged legislation was enacted:

> "[E]ventually the evolution of a frontier society to a modern State, attended by the discovery of oil and gas deposits which led to speculation and exploitation of the changes in the use and value of the lands, called forth amendments to the Texas land laws modifying the conditions of sale in favor of the State. 379 U.S. at 511.
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> "The program adopted at the turn of the century for the sale, settlement, forfeiture and reinstatement of land was not wholly effectual to serve the objectives of the State's land program many decades later." *Id.* at 516.

In the present case, there have been no unforeseen or unexpected developments since 1962. Quite the contrary, continuing traffic and rail mass transit difficulties were not only foreseen but were expected in 1962. In fact, it was the probability of such difficulties that prompted investors to

demand, and the State to enter into, the 1962 Covenant. The problems had existed for years and had been described from the 1920's on by various commissions and knowledgeable individuals as: "disastrous" (1925 Report of the North Jersey Transit Commission; Stip. 71-72); "an acute present problem, the solution of which is vital to the welfare of an army of our citizens." (1927 Report of the North Jersey Transit Commission; Stip. 79); "the need for a very broad solution thereof becomes a paramount necessity today." (Letter of Commissioner, New Jersey Department of Conservation and Economic Development of the Governor, dated February 10, 1961; Stip. 91); "Transit in the New York-New Jersey Metropolitan Area is on the brink of catastrophe." (1955 Report of Metropolitan Rapid Transit Commission; Stip. 100); "The moment when further forgetfulness will invite final oblivion is upon us." (1956 Report of Metropolitan Rapid Transit Commission; Stip. 104); "Recent trends towards decay of existing systems, particularly in respect to transportation services crossing the Hudson River, have created a condition of impending emergency. . . ." (Public Law 86-302; 73 Stat. 575 (1959); Stip. 125-26); and "New Jersey has for a considerable period been in the throes of a transportation crisis." (1960 Report of New Jersey State Highway Department, Division of Railroad Transportation; Stip. 133). In 1962 there was a pressing need for rail mass transit, for a variety of reasons. Today there is the same pressing need for rail mass transit for the very same reasons. The only "need" that repeal of the Covenant cures is the need to pass the burden of paying for rail mass transit from the public at large to a certain small segment of the public—those who bought Port Authority bonds.

5. If the Covenant has resulted in "unexpected benefits" they are benefits to the State and not to the Port Authority's bondholders.

This Court in *El Paso* found that the "unforeseen developments" in that case resulted in conferring "considerable advantages on the purchaser" while imposing "a costly and difficult burden on the State," and that the challenged legislation modifying the right to reinstatement merely restricted the parties to those gains reasonably to be expected from the contract. *Id.* at 515.

As a result of the Covenant the State obtained precisely what it bargained for, the take-over, improvement and operation of the bankrupt H & M line by the Port Authority. In return the State surrendered the right to impose any other perpetual deficit rail mass transit projects on the Port Authority without certain restrictions. Based on the passage of the Covenant legislation bondholders invested over one billion dollars in private capital in the Port Authority thus enabling the Authority to finance, *inter alia*, the ever growing deficit of PATH. Bondholders also obtained precisely what they bargained for—protection of pledged revenues and reserves against unlimited involvement in deficit rail mass transit.

6. The Covenant was not merely modified by the challenged legislation; it was totally abrogated.

El Paso is clearly distinguishable from this case because there the agreement made by the State was merely modified in a reasonable way whereas here it was totally abrogated.

Since the Texas statute offered a 5-year grace period from the date of enactment during which a defaulting purchaser, after decades of non-payment, could preserve his interest, the legislative measure was a "mild one indeed". *Id.* at 516. If, however, the right to reinstatement had been cut off upon the enactment of the challenged legislation, this

Court would have been faced with legislation more akin to the 1974 repeal legislation and might well have held such legislation to be unconstitutional.

V.

Chapter 25 of the Laws of New Jersey of 1974 Violates the Fifth and Fourteenth Amendments to the United States Constitution.

The retroactive repeal of the 1962 Covenant also contravenes the Fifth and Fourteenth Amendments to the Federal Constitution.

The superior court did not consider the due process issue on the grounds that (1) it had "factually rejected" the claim that there had been damage to the secondary market for Port Authority bonds and (2) the test of constitutional validity is the same under the Contract and Due Process Clauses.

Rights under a contract have long been deemed to be property entitled to protection under the Due Process clauses. "Valid contracts are property whether the obligor is a private individual, a municipality, a state or the United States." *Lynch* v. *United States,* 292 U.S. 571 (1933); *Wright* v. *Hart,* 182 N.Y. 330, 334 (1905); *see also Tilton* v. *City of Utica,* 60 N.Y.S.2d 249, 263-65 (1946). As discussed above, the 1962 Covenant constituted a contract between the States of New York and New Jersey and with holders of Consolidated Bonds of the Port Authority. This contract was extinguished by the repealing legislation which made no provision for compensating the holders of Consolidated Bonds.

The Due Process and Contract Clauses are often considered together, and several cases and commentators have indicated that the same test is frequently utilized to determine the validity of repealing legislation under the two

Clauses. *Veix* v. *Sixth Ward Building & Loan Association,* 310 U.S. 32 (1940); Hale, *The Supreme Court and the Contract Clause,* 57 Harv. L. Rev., 852, 890, 891 (1944); and Hochmann, *Retroactive Legislation,* 692, 695 (1960). A law, therefore, which unlawfully impairs a contract will also result in a deprivation of property without due process.

The Due Process Clause test has the additional requirement that there must be just compensation for property taken. Justice Black focused on this element of due process in his dissent in *El Paso.* In language which seems particularly fitting for the present case, Justice Black observed:

> ". . . I think the Fifth Amendment [as made applicable to the States by the Fourteenth Amendment] forbids Texas to do so without compensating the holders of contractual rights for the interests it wants to destroy. Contractual rights, this Court has held, are property and the Fifth (through the Fourteenth) Amendment requires that property shall not be taken for public use without just compensation. . . ." 379 U.S. at 533-534.
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> "Our Constitution provides that property needed for public use, whether for schools or highways or any other purpose, shall be paid for out of tax raised funds fairly contributed by all the taxpayers, not just by a few purchasers of land who trusted the State not wisely but too well." *Id.* at 534-35.

It was Justice Black's position that, even if the legislation in question was justifiable by reason of the police power exception to the Contract Clause, it still violated the Due Process Clause because no provision was made for compensating those whose property was taken.

Justice Black's arguments were cited with favor in Note, 51 Virginia Law Review 692 (1965):

> "One need not accept all of the dissent's constitutional absolutism to agree that under the view that the statute actually impaired a vested contract right,

> the decision upholding it on police power grounds seems to carry within it the potential for future encroachments on the just compensation requirement. The power of a state to destroy contracts by statute where it stands to gain direct pecuniary benefit can be questioned seriously on grounds of ethics, policy and precedent." *Id.* at 701-702.

The action of the States resulted in immediate financial loss to the Port Authority's bondholders by reason of the decline in the secondary market for their bonds and the relative lack of marketability of their bonds. The States could have offered to increase the interest on the Consolidated Bonds (as was done for the bondholders of Triborough Bridge and Tunnel Authority at the time that Authority was merged into the Metropolitan Transit Authority in 1968), or offered to refund the bonds or to pledge additional security to insure their repayment. Instead, no compensation was offered to the bondholders, thus depriving them of vested property rights without compensation in violation of the Due Process Clause. *See* Kraft and St. John, *The Contract Clause as the Guardian Against Legislative Impairment of Municipal Bondholders' Rights,* 6 Seton Hall L. Rev. 48, 50 n. 11 (1974); *Louisville Joint Stock Land Bank* v. *Radford,* 295 U.S. 555, 602 (1935).

Conclusion

The decision of the trial court should be reversed and the declaratory judgment sought by the Trust Company should be granted. The 1974 Legislation contravenes the Contract Clause of the United States Constitution and is a taking of bondholders' property without compensation in violation of the Due Process Clause. Chapter 25 of the Laws of New Jersey of 1974 is void.

Respectfully submitted,

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